Sea Wk. 3197

In the United States Court of Appeals for the Ninth Circuit

No. 18252

THE SUPERIOR OIL COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL POWER COMMISSION

BRIEF FOR THE FEDERAL POWER COMMISSION

RICHARD A. SOLOMON,
General Counsel,
HOWARD E. WAHRENBROCK,
Solicitor,
PETER H. SCHIFF,
Attorney,
For respondent.
Federal Power Commission,
Washington 25, D.C.

March 11, 1963.

INDEX

677819—63——1

TABLE OF CITATIONS

Cases—Continued

Cases—Continued

Cases—Continued

Statutes and Regulations—Continued

In the United States Court of Appeals for the Ninth Circuit

No. 18252

The Superior Oil Company, petitioner

v.

Federal Power Commission, respondent

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL POWER COMMISSION

BRIEF FOR THE FEDERAL POWER COMMISSION

STATEMENT OF JURISDICTION

This is a proceeding to review an order of the Federal Power Commission issued on June 15, 1962 (R. 120), reported at 27 FPC 1266. Petitioner's application for rehearing (R. 123–131), filed on July 9, 1962, was denied on August 8, 1962, by the Commission's non-action within 30 days. Section 19(a) of the Natural Gas Act, 15 U.S.C. 717r(a)[1]; F.P.C., Rules of Practice and Procedure, Section 1.34, 18 C.F.R. 1.34. The petition for review was filed on October 5, 1962. Jurisdiction of this Court rests upon Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).[2]

STATEMENT OF THE CASE

Petitioner, an independent producer of natural gas, seeks review of an order (R. 120) rejecting an application for a certificate of public convenience and necessity and the related proposed rate schedule, which were based on a contract containing certain price-changing provisions other than those allowed by Section 154.93 of the Commission's regulations. The basic question involved is whether the Commission's regulations limiting the types of price-changing provisions permissible in producer contracts constitute a reasonable exercise of the Commission's rule-making authority.

The Commission's regulations under the Gas Act, Section 154.91, *et seq.*, provide that independent producers who

---

[1] Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821–833, as amended, 15 U.S.C. 717–717w. For the convenience of the Court pamphlet copies of the Act, as well as pamphlet copies of the Commission's "Rules of Practice and Procedure" and "Regulations under the Natural Gas Act," will be lodged with the Clerk prior to argument.

[2] Superior seems to base its jurisdictional claim on Section 10 of the Administrative Procedure Act as well as Section 19(b) of the Gas Act (Pet. Br. p. 1). It is clear, however, that Section 10 of the Administrative Procedure Act, 5 U.S.C. 1009, does not grant a right of review not given by the Natural Gas Act. *F.P.C.* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 500; *Wisconsin* v. *F.P.C.*, 292 F. 2d 753 (CADC); *Magnolia Petroleum Co.* v. *F.P.C.*, 236 F. 2d 785, 793 (CA 5), certiorari denied, 352 U.S. 968; *Amerada Petroleum Corp.* v. *F.P.C.*, 231 F. 2d 461, 465 (CA 10).

are natural gas companies subject to the Commission's jurisdiction under the Gas Act shall file their contracts as their rate schedules, and Section 154.93 provides in part:

> * * * That in contracts executed on or after April 3, 1961, for the sale or transportation of natural gas subject to the jurisdiction of the Commission, any provision for a change of price other than the following provisions shall be inoperative and of no effect at law; the permissible provisions for a change in price are:
>
> (a) Provisions that change a price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller;
>
> (b) Provisions that change a price to a specific amount at a definite date; and
>
> (c) Provisions that, once in five-year contract periods during which there is no provision for a change in price to a specific amount (paragraph (b) of this section), change a price at a definite date by a price-redetermination based upon and not higher than a producer rate or producer rates which are subject to the jurisdiction of the Commission, are not in issue in suspension or certificate proceedings, and, are in the area of the price in question * * *.[3]

That section of the regulations also provides that "any contract executed on or after April 2, 1962, containing price-changing provisions other than the permissible provisions" described above "shall be rejected." Section 157.25 of the regulations similarly provides that an independent producer application for a certificate of public convenience and necessity "shall be rejected" if any contract submitted in support thereof contains non-permissible price-changing provisions, and Section 157.14(a)(10)(v) provides that any producer contract executed after April 2, 1962, containing any non-permissible price-changing clauses "will be given no consideration in de-

[3] The quoted language was added to the regulations by Order No. 232, issued March 3, 1961, (App. A, *infra*, pp. 49–54, 25 FPC 379, 26 Fed. Reg. 1983), as amended by Order No. 232A., issued March 31, 1961 (Pet. Br. App. C, pp. 17a–20a, 25 FPC 609, 26 Fed. Reg. 2850).

termining adequacy" of a pipeline company's gas supply showing in support of a certificate application. These provisions were added to the regulations by Order No. 242, issued February 8, 1962 (Pet. Br. App. B., pp. 13a–16, 27 FPC 339, 27 Fed. Reg. 1356).

Procedural history of the regulations.—Orders No. 232 and 232A, which amended Section 154.93 by limiting the types of price-changing provisions that would be permissible in producer contracts executed after the effective date of those orders, were issued in a rule-making proceeding initiated by a notice of proposed rule-making published in the Federal Register on April 12, 1956 (21 Fed. Reg. 2388) and by mailing notices to interested parties, including state and federal regulatory agencies (App. A, *infra,* p. 49, 25 FPC at 380). In that notice (21 Fed. Reg. 2388), the Commission stated that it proposed to amend its regulations relating to independent producers to describe certain types of contracts for the sale of natural gas which would not be accepted for filing as rate schedules. Its specific proposal was that the Commission would not accept for filing contracts containing provisions calling for price adjustments based on "(a) escalation clauses based on price indices or changes in the price received by the purchaser upon resale, or (b) the payment or offer of payment of higher prices by the purchaser or other purchasers in the same or other producing areas to the same or other sellers" (21 Fed. Reg. 2389).

The Commission, in its notice, invited comments on or before June 1, 1956, and stated that it would not act prior to that date (21 Fed. Reg. 2389). Numerous responses were received by the Commission, both in support of the proposed rule and in opposition, including a protest from the petitioner (See App. B, *infra,* pp. 55–59). Thereafter, the Commission in *Pure Oil Co.,* 25 FPC 383, affirmed, 299 F. 2d 370 (CA7), received the benefit of extensive hearings, briefs and oral arguments on the issue of whether or not favored-nation clauses are contrary to public policy.[4]

---

[4] While that case was decided on the ground that the favored-nation clause had not been triggered, the Commission, as stated in Order No. 232, explained there why it regarded indefinite escalation clauses to be contrary to the public interest. *Pure Oil Co.,* 25 FPC 383, 387–391.

The rule making proceeding resulted in the issuance on March 3, 1961, of Order No. 232 (App. A, *infra,* pp. 49–54, 25 FPC 379). In that order the Commission found that long-term gas supply contracts containing indefinite escalation clauses, which it defined as all price escalation provisions other than those calling for increases of specific amounts at definite dates or those intended to reimburse the seller for all or any part of changes in production, severance or gathering taxes levied on the seller, "* * * have contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies," and that these clauses are contrary to the public interest as found in *Pure Oil Co.,* 25 FPC 383. For these reasons, the Commission amended its regulations to prohibit the use of indefinite escalation provisions in new producer contracts. It did so by adding definitions of "definite" and "indefinite" escalation clauses to Section 154.91 of its regulations and by adding a proviso to Section 154.93 of its regulations declaring that any provision for a change of price based on an indefinite escalation clause in a contract filed on or after April 3, 1961, would be "inoperative and of no effect at law", *infra,* App. A, p. 51, 25 FPC at 381. Order 232 also provided that the amendments to the regulations there promulgated would become effective April 3, 1961. The order provided further that any interested person could submit written views or comments to the Commission by March 20, 1961. *Ibid.*

On March 31, 1961, the Commission, upon consideration of many comments filed by interested persons (none were filed by the present petitioner), issued Order 232A to modify the amendments to the regulations promulgated by Order 232. In this order, the Commission found that it "appears that elimination of all indefinite escalation provisions would be too restrictive to enable the industry adequately to cope with possible changing economic conditions over the span of long-term contracts. Therefore, to permit pricing flexibility and to provide an incentive for long-term contracts, we should permit future contracts to contain limited price-redetermination provisions, invocable not more than once in every five-year contract period and based upon rates subject to this Commission's jurisdiction (and therefore, controlled)". Pet. Br., App. C, pp. 17a–18a, 25 FPC 609–610. It also concluded that the amendment to the regulations should apply only to contracts "executed" on or after April 3, 1961 (under Order 232 the amendment would have applied to contracts "filed" on or after that date, whenever executed).[5]

Order 242, which spelled out the procedures to be used in effectuating the amended provisions of Section 154.93 of the regulations promulgated by Order 232A, was also issued as a rule of general applicability.

The rule-making proceeding resulting in Order 242 was initiated by a notice of proposed rule-making published in the Federal Register on October 14, 1961 (26 Fed. Reg. 9732), and by mailing notices to interested persons, including natural gas companies, and to State and Federal agencies (Pet. App. B, p. 13a, 27 FPC 339). In that notice, the Commission noted that in Order No. 232A it had amended Section 154.93 of its Regulations to provide that, with certain exceptions, indefinite price changing provisions in producer contracts executed on or after April 3, 1961, would be inoperative and of no effect at law. It then explained (26 Fed. Reg. 9732):

> Having found in Order No. 232A that indefinite escalation provisions "* * * are generally undesirable, unnecessary and incompatiable with the public interest for the due and proper development of natural gas service by natural gas companies * * *", it appears that no useful purpose can be served by the Commission's acceptance of contracts containing indefinite price escalation provisions or of applications relying upon contracts having such provisions as proof of the applicants' gas supply.

The specific amendments proposed were substantially the same as those eventually adopted in Order No. 242, except that the proposed regulations would have rejected rate schedules or certificate applications *filed* after the specified date, rather than only those *executed* after the specified date as provided by Order No. 242.

---

[5] Sun Oil Company's petition to review the Order No. 232 and 232A was dismissed for lack of jurisdiction. *Sun Oil Co.* v. *F.P.C.*, 304 F. 2d 293 (CA5), certiorari denied, 371 U.S. 861.

The Commission, in its notice, invited comments on or before November 13, 1961 (*Ibid.*). Numerous responses were received by the Commission, both in support of the proposed rule and in opposition (Pet. App. B, p. 13a, 27 FPC 339), including comments from the present petitioner. See App. C, *infra*, pp. 60–64. While challenging both the validity and need for the proposed amendment to the regulations, as well as those adopted by Order 232A, petitioner stated that if the Commission concluded in a certificate proceeding that particular price-changing provisions "so vitiated the contract as to make it not in the public interest, the Commission clearly has the power under the Natural Gas Act to deny a Certificate of Public Convenience and necessity to the independent producer." App. C, *infra*, p. 64.

On February 8, 1962, the Commission issued Order No. 242 (Pet. App. B, pp. 13a–16a, 27 FPC 339). While the new order simply spelled out a procedure for implementing the existing regulation, the Commission again explained the basis for the existing regulations, the validity of which had been challenged in many of the comments. The Commission explained, *inter alia,* that it could not acquiesce in the use of contracts which include provisions which prevent effective rate regulation and that the existing regulation and the amendments thereto were necessary or appropriate to correct the impediment to regulation caused by the proscribed indefinite price-changing provisions.[6]

---

[6] A number of producers, including the present petitioner (see App. D., *infra*, pp. 65–68), filed applications for rehearing of Order 242. After these were denied on April 4, 1962 (27 FPC 666), six petitions for review of that order were filed. In response to our motions to dismiss on the ground that the order was not reviewable prior to a specific application, the Fifth Circuit dismissed the petitions of Hunt Oil Company, Humble Oil Refining Company and petitioner (*Hunt Oil Co.* v. *F.P.C.*, 306 F. 2d 878 (CA5)) and the Third Circuit dismissed Shell Oil Company's petition. *Shell Oil Co.* v. *F.P.C.*, CA3, No. 14058, decided July 17, 1962 (not reported). The motions to dismiss the petitions of Pan American Petroleum Corporation and Sun Oil Company are still pending in the Tenth Circuit, Nos. 7002 and 7179. That Court, which deferred action on our motions to dismiss until hearing upon the merits, has scheduled arguments on the merits for March 18, 1963.

It may be noted that in addition to the present challenge of these regulations upon an application thereof, two other petitions have been filed as

The order under review.—On the basis of these regulations, the Commission, on June 15, 1962, rejected (1) Superior's application of May 25, 1962, for a certificate of public convenience and necessity authorizing it to sell gas to El Paso Natural Gas Company from previously undedicated acreage in Aneth Field, Utah, pursuant to an agreement of April 9, 1962, containing non-permissible price changing provisions, and (2) the related rate filing (R. 120).

The April 9, 1962, agreement (R. 107–110), which dedicated 2640 acres for the sale of gas to El Paso, incorporated by reference the provisions of a 20-year casinghead gas contract between Superior and El Paso dated June 11, 1958, as thereafter supplemented (R. 11–47, 59–62, 67–70, 78–81, 93–94, 100–101). Nothing in the June 11, 1958, contract, which was in form amended by the April 9, 1962, agreement, required or expressly permitted Superior to add acreage to that originally listed. The pricing terms adopted by the April 9, 1962, agreement called for an initial price of 20¢ per Mcf for the first five years commencing with the date of initial delivery under the original contract, 21¢ per Mcf for the second five-year period, 22¢ per Mcf for the third five-year period, 23¢ for the fourth five-year period, and 24¢ per Mcf thereafter if the contract remained in effect (R. 30–1, 39). (The initial price was reduced to 17.7 cents per Mcf, in accordance with the condition attached to the certificate issued by the Commission for sale under the 1958 contract, R. 100–101). However, in addition to these permissible fixed-price escalation provisions, the provisions of the 1958 contract incorporated into the April 9, 1962, agreement also provided for a price redetermination for each five-year period after the first (R. 31–32) and included a so-called favored-nation clause providing that El Paso would never pay petitioner less than the price it was paying "others for comparable gas delivered under comparable conditions" within a specified area (R. 32).

a result of other rejections based on those regulations. *Texaco Inc.* v. *F.P.C.*, CA10, No. 7217 (argument set for March 18, 1963; motion to dismiss for lack of proper venue also pending); *Sun Oil Co.* v. *F.P.C.*, CA5, No. 20290, petition for review filed January 28, 1963.

677819—63——2

The price redetermination clause provides specifically (R. 31–32):

> Seller shall have the right, at its option, to request a redetermination of the price provided in Section 7 of this Article to be paid for any one or more or all (but not part) of the periods set out in (b), (c), (d) and (e) above. Any such request made with respect to any of such periods shall be made in writing during the six (6) months immediately preceding the commencement of such period. If Seller shall make any such request, representatives of Buyer and Seller shall promptly meet and attempt to determine the then reasonable market price of the gas deliverable hereunder. In making such determination, consideration shall be given to all pertinent factors. The price so determined by Buyer and Seller shall be the price applicable during the entire period with respect to which the same was determined; provided, that if such price shall be less than the price provided in Section 7 of this Article with respect to such period, the price during such period shall be as provided in Section 7.

The favored-nation clause provides (R. 32):

> Buyer agrees that the price to be paid from time to time to Seller hereunder for Residue Gas shall never be less than the price being paid by Buyer to others for comparable gas delivered under comparable conditions within the area shown on Exhibit "B" attached hereto.

On July 9, 1962, within the statutory 30-day period after the Commission's rejection of petitioner's tendered application for a certificate and proposed rate schedule, petitioner filed its "Application for Reconsideration of Rejected Supplement to Rate Schedule" (R. 123–131). There petitioner complained that the summary rejection of its certificate application and related rate schedule filing was invalid because the regulations on which the Commission relied were invalid, the regulations and the rejection order were improperly issued without opportunity for hearing, and in any event the Commission cannot, even in a rate or certificate proceeding, modify provisions of contracts which "do not affect the initial 'rate charge or classification'" (R. 126).[7] Petitioner did not contend that its contract did not contain proscribed price-changing provisions and made no request for a waiver of the regulations as to this sale. Since the Commission did not act on petitioner's application for rehearing, it was deemed to have been denied on August 8, 1962 (*supra*, p. 1). The petition for review followed.

SUMMARY OF ARGUMENT

The only real issue presented by this case is the validity of the Commission's regulations limiting the types of price-changing provisions that may be included in producer contracts executed after the regulations were promulgated. For it is clear that if the regulations are valid the Commission was free to reject petitioner's certificate and rate filings which were inconsistent with those regulations. See, *e.g.*, *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192.

I. We show first that the Commission had a reasonable basis for finding and concluding that the challenged regulations are reasonable and necessary or appropriate to permit the effective regulation contemplated by the Natural Gas Act. Petitioner is wrong in saying that these regulations proscribe all provisions for contract flexibility and substantively limit the price that producers many charge. To the contrary, the regulations permit all fixed price escalations, and permit limited redeterminations every five years, and thus allow broad pricing flexibility during the course of long-term contracts, but, unlike the proscribed favored-nation and unlimited price-redetermination provisions in petitioner's contract, do so without frustrating effective rate and certificate regulation by the Commission. A number of considerations show the absence of any justifiable need for the proscribed provisions.

The Commission was fully justified in concluding that those clauses have impeded effective regulation. Thus experience has shown the Commission that they have induced increased rate filings without any individual determination by the filing

---

[7] As we noted, *supra*, p. 6, in its comments on proposed Order 242, petitioner had flatly asserted the rule was unnecessary since the Commission, could deny a certificate if the contract was not in the public interest.

company as to its needs, solely because under such provisions a contract right to file came into existence. As illustrated, *infra*, pp. 21–25, the proscribed clauses raise many complex questions of contract interpretation and application which have to be resolved by the Commission to determine whether a particular filing based on one of the proscribed provisions was contractually authorized, since the courts have held that contractually unauthorized filings must be rejected by the Commission. This need to resolve such complex contract questions to determine Commission jurisdiction necessarily impairs its ability to determine whether to exercise its suspension power within the 30-day period available, and to fulfill its primary obligation of determining just and reasonable rates "as speedily as possible." Section 4(e) of the Act.

In addition, the increased prices provided for by many of the proscribed clauses, including those in petitioner's contract here, are indeterminate. In such circumstances, the Commission cannot realistically determine whether the rate should be suspended and a hearing initiated to determine its reasonableness because of the uncertainity as to the exact rate.

Furthermore, the proscribed clauses also impede the Commission's obligation to provide effective certificate regulation. Thus, as this Court has held, in producer certificate cases the Commission must give careful scrutiny to proposed producer prices in an attempt to "hold" the price line. That requires a consideration of the full pricing terms of a contract, not just the initial price. If prices can be changed to indeterminate amounts at any time, even the first day after a certificate is to be issued, such a comparison becomes impossible.

Finally, the proscribed price-changing provisions in producer contracts make any showing of the economic feasibility of a pipeline's project very speculative, though the necessity for such a showing in certificate cases has long been recognized. This is so because such a showing depends on evidence of a market to ultimate consumers. But since the size of that market demand will depend to a considerable extent upon the price to be charged for the gas, relative to the cost of competing fuels, the completely indeterminate pricing which would be possible under the proscribed clauses may preclude any realistic estimates of market demand.

These considerations show that the Commission had a reasonable basis for promulgating the challenged regulations. Thus, this Court should approve the regulations since a court will set aside agency regulations only if no reasonable basis therefor is apparent, even if the court might not have acted in precisely the same way. See, *e.g., American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298, 314.

II. The Commission has clear authority to regulate contract provisions by rules or regulations. Section 16 of the Gas Act specifically empowers the Commission to issue such rules and regulations "as it may find necessary or appropriate to carry out the provisions" of the Act. We do not argue that this authority may be used in a manner inconsistent with the Act, for the regulations here involved are fully consonant with the Act, and, contrary to petitioner's assertions, are predicated upon substantive powers found in specific sections of the Act. We show first the source of the substantive power over contracts and then that the Commission may exercise that power in rule-making proceedings of general applicability, as well as by *ad hoc* determinations.

Initially, it is apparent that there is no basis for petitioner's contention that the Natural Gas Act precludes the Commission from modifying contracts. Sections 5(a) and 4(e) expressly authorize the Commission to change contracts, as well as rates, in rate proceedings. This clear power has been recognized judicially.

Similarly, Sections 7(a) and 7(e) of the Act authorize the Commission to consider and modify rate structures and contracts in issuing certificates of public convenience and necessity. As we show in detail, *infra,* the Commission's power to modify contracts in certificates proceedings is at least as great as in Sections 4 or 5 rate proceedings. Judicial decisions, as well as the legislative history of Section 7, leave no doubt that rate structures and contract provisions are to be considered prior to the initiation of service, and the Commission has long exercised such authority in certificate proceedings.

While Sections 4, 5 and 7, from which the Commission's substantive power over contracts is derived, provide for hearings before action on individual rate or certificate filings, petitioner's contentions that these procedural provisions curtail the Commission's authority under Section 16 to carry out by general rule the regulation of contracts authorized by these sections is without merit. *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, rejected virtually identical contentions.

III. Petitioner's contentions that the regulations are discriminatory because pipeline companies have not been subjected to the same regulations as producers, ignores the fact that mere difference in treatment of different classes of companies does not invalidate a regulation. Since inception of producer regulation, pipelines and producers have reasonably and necessarily been accorded different treatment by Commission regulations. *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division,* 358 U.S. 103, while holding that the Gas Act did not automatically prohibit inclusion in pipeline service agreements of provisions permitting pipelines to increase their rates at will, did not, contrary to petitioner's claim, indicate that the Commission must tolerate types of escalation provisions destructive of effective regulation.

Petitioner's further claim of discrimination because it had previously received certificate authorization to sell gas from adjacent acreage pursuant to contract terms identical to those now rejected is frivolous. For the Commission is, of course, free to reexamine its earlier decisions and reach different results in the event of changed circumstances. Moreover, petitioner's attempt to treat its new agreement to sell previously uncommitted gas as part of an earlier contract cannot disguise the fact that a contract which voluntarily adopts or incorporates the terms of an earlier contract solely for the convenience of the parties is a new contract as a matter of law.

IV. Finally, the fact that some of the proscribed price-changing provisions have in the past been given effect both by the courts and the Commission before the adoption of the rule in no way limits the Commission's power to adopt the rule. For whether or not a contract clause is valid as a matter of general law, its legality under a supervening regulatory scheme is a separate question. We also show that the Commission has long indicated its disapproval of the proscribed clauses and that its requests for Congressional proscription of most indefinite escalation clauses in both existing and future producer contracts, which were made as part of a package request for modifications of the Act with respect to independent producer regulation, gave no indication that the Commission doubted its power to adopt the challenged regulations, which, unlike the requested legislation, have prospective effect only.

ARGUMENT

Petitioner's basic contention is that the Commission order rejecting its filings was based on invalid Commission regulations. Its preliminary contention (Br., pp. 8–18) that even if these regulations, which provide for rejection of producer certificate applications and rate schedule filings based on contracts containing proscribed price-changing provisions, were valid, the Commission may not reject its filings without a hearing is, in fact, no more than a challenge of the regulations which provide for such summary rejections. And, in any event, as we discuss more fully below, *infra,* pp. 36–41, the validity of rejection without hearing of unauthorized certificate or rate filings has been fully established. See, *e.g., United States* v. *Storer Broadcasting Co.,* 351 U.S. 192, 205; *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.,* 350 U.S. 332, 347; *Amerada Petroleum Corp.* v. *F.P.C.,* 293 F. 2d 572 (CA10), certiorari denied, 368 U.S. 976. Therefore, it is apparent that the only real issue before the Court is the validity of the challenged regulations.

I. The Commission had a reasonable basis for issuing the regulations limiting the types of rate-changing provisions permissible in producer contracts

The regulations which petitioner challenges do not, as it seems to imply (*e.g.,* Br. pp. 18, 45), proscribe all contract provisions for price flexibility. On the contrary, the regulations permit a number of types of price escalation clauses providing broad pricing flexibility over the customary long terms of these contracts without the needless complexities, arising from the proscribed clauses, which frustrate regulation; without inducing the filing of many rate increases irrespective of economic justification, as the proscribed clauses would; and without permitting contract price instability, which frustrates the full regulatory protection for the consumer that the Commission's certificate authority was intended to provide.

In issuing rules under Section 16 of the Gas Act which it deems "necessary or appropriate to carry out the provisions" of the Act, the Commission must, of course, have a reasonable basis for the exercise of its judgment. See, *e.g.*, *American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298, 314; *Air Line Pilots Association, International* v. *Quesada,* 276 F. 2d 892, 898 (CA2) and 286 F. 2d 319 (CA2), certiorari denied, 366 U.S. 962. The challenged rules clearly meet this test. For while, as petitioner emphasizes (Br. pp. 15, 35), the Natural Gas Act did not itself abrogate private gas sales contracts as such, this does not mean that the Commission must tolerate contract provisions, such as the price-changing provisions proscribed here, which in themselves thwart the effective rate regulation which the Act is intended to provide. Indeed, as we discuss, *infra,* pp. 29–36, contracts while not abrogated by the Act itself, remain subject to the paramount regulatory authority of the Commission. On the basis of its experience the Commission found in Orders 232 and 232A that the indefinite price changing provisions there proscribed hinder effective regulation of natural gas companies, and that the permitted price-changing provisions afford a sufficient means of achieving desirable price flexibility in long-term contracts. Order 242 did not make any substantive changes in those proscriptions, but merely spelled out the consequences that would ensue if contracts containing any of the proscribed provisions were offered in Commission rate or certificate proceedings.

A. The price-changing provisions permitted by the regulations provide all the price flexibility that is reasonably necessary

It should be emphasized at the outset, in view of petitioner's claims that the challenged regulations limit the prices that may be charged in the future, that these regulations control only the type of contract provision allowed, not the prices to be charged, and, as we have said, do not even proscribe all indefinite pricing provisions.

The Commission was clearly reasonable in believing that the permitted price-changing provisions—fixed periodic price increases, increases reflecting certain tax increases, and price redeterminations every five years based on jurisdictional rates not questioned in rate suspension or certificate proceedings (Section 154.93 of the regulations, 18 C.F.R. (Cum. Supp. 1962) 154.93)—offered producers a broad scope of alternative price-changing provisions in long-term contracts that are more than adequate to meet all their legitimate needs.[8] This is illustrated by the fact that even before issuance of Orders 232 and 232A the Commission had approved at least 119 rate settlements in which producers agreed with the pipelines to substitute fixed periodic increases for favored-nation and price-redetermination clauses in existing contracts. See, *e.g.*, *Petroleum Leaseholds, Inc.* (Operator), 21 FPC 799; *Nemours Corporation* (Operator), 23 FPC 84. Many more such settlements have been agreed to since that time even though the regulations in no way affect contracts executed prior to April 3, 1961. Furthermore, many producer gas sales contracts, including some of Superior's own contracts on file since prior to the challenged regulations, provide only for fixed price periodic increases and tax reimbursement increases.

Nevertheless, because many producers sought permission after the issuance of Order 232, to have more flexible pricing provisions than that order allowed, the Commission concluded that within specified limits, price-redeterminations no more frequently than once every five years would be permissible, provided such increases were based upon and not higher than producer rate or rates subject to Commission jurisdiction and not questioned in suspension or certificate proceedings.

Contrary to petitioner's assertions (*e.g.*, Br. pp. 18, 45), the regulations at issue here impose no price ceilings on producer escalations for there is no limit on the frequency or amount of

---

[8] Moreover, there is nothing in the challenged regulations which precludes a producer from selling under a short-term contract at the termination of which it would be free to file rate changes at will. See *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137, 155.

permissible fixed escalations.[9] Rather, the regulations affect only the triggering mechanisms for filing such increases. If a producer were in a bargaining position to require inclusion of the proscribed indefinite escalation provisions prior to the regulations, it is not apparent why it cannot insist on higher or sufficiently frequent periodic escalations to permit it to obtain the same prices throughout the term of a contract, without the same undesirable and regulation-impeding consequences discussed hereinafter (*infra*, pp. 18–28).

If as producers have sometimes contended, indefinite periodic price adjustment is necessary to induce them to make commitment of a large gas supply which might otherwise be sold in smaller and segmented packages so as to take advantage of possible increases in market prices, the allowable price-redetermination clause would achieve that result. For there is no reason to assume that, in a given area, new sales from previously undedicated acreage would be certificated at prices in excess of prices previously authorized by the Commission.

In any event, while indefinite escalation clauses may have had some justification when they were developed in the 1940's this no longer exists. Then it was uncertain how strong the demand for natural gas would become, there was still a lack of purchaser outlets, and the Commission had not undertaken to regulate producer prices. But now, as the Commission explained in *Pure Oil Co.*, 25 FPC 383, at 391, affirmed, 299 F. 2d 370 (CA7),

> * * * purchasers of gas are numerous, consumer demand is strong, and buyers are competing eagerly for available supplies of gas. In our judgment, in the light of continuing increases in the price of gas in recent years and the present high level of prices, escalation clauses such as Pure's have by now outlived whatever economic function they may have had.

---

[9] Petitioner's misconception of the regulations is also illustrated by the completely unfounded view, expressed in its petition for rehearing of Order No. 242 (App. D, *infra*, p. 67), that the regulations limit periodic escalations to one cent per Mcf every 5 years or to a total increase of 3 cents per Mcf during a twenty year contract.

In present circumstances, not only because supply and demand is much more in balance, but also because of the actual Commission regulation now exercised over producer prices, companies are much more able to project, even over a twenty-year contract period, what specific escalations would be needed to file for rates the Commission would approve. That, of course, is the only relevant yardstick since, under regulation of producer prices, price escalation provisions provide only the basis or authorization for making an increased-rate filing, with the actual rates being subject to full Commission review. See, *e.g.*, *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137, 152–153.

Moreover, it should be noted that in the event that special or changed circumstances exist when a producer seeks to make certificate or rate filings based on contracts containing non-permissible price changing provisions, it would be free to make such a showing at the time of filing and may, at that time, seek modification or waiver of the challenged regulations.[10]

Petitioner made no request for a waiver here.

---

[10] Section 1.7 (a) and (b) of the Commission's regulations provides:

"(a) *General.* Petitions for relief under any statute or other authority delegated to the Commission shall be in writing and under oath, shall state clearly and concisely the petitioner's grounds of interest in the subject matter, the facts relied upon, and the relief sought, and shall cite by appropriate reference the statutory provision or other authority relied upon for relief and shall conform to the requirements of §§ 1.15 and 1.16." 18 C.F.R. 1.7(a).

"(b) *For issuance, amendment, waiver, or repeal of rules.* A petition for the issuance, amendment, waiver, or repeal of a rule by the Commission shall set forth clearly and concisely petitioner's interest in the subject matter, the specific rule, amendment, waiver, or repeal requested, and cite by appropriate reference the statutory provision or other authority therefor. If a rate filing is accompanied by a request for waiver pursuant to this section the thirty-day notice period provided in section 4(d) of the Natural Gas Act and section 205(d) of the Federal Power Act shall begin to run if and when the Commission grants the request. Such petition shall set forth the purpose of, and the facts claimed to constitute the grounds requiring such rule, amendment, waiver, or repeal, and shall conform to the requirements of §§ 1.15 and 1.16. Petitions for the issuance or amendment of a rule shall incorporate the proposed rule or amendment." 18 C.F.R. 1.7(b), as amended, Order No. 255, 27 Fed. Reg. 9499, September 26, 1962, and 27 Fed. Reg. 11001, November 6, 1962.

B. The Commission reasonably concluded that the proscribed clauses impede effective regulation

1. *The proscribed clauses induce the filing of rate increases irrespective of economic justification*

Not only are the proscribed contract provisions unnecessary to protect the legitimate business interests of independent producers but, as we now discuss, the Commission had ample reasons for concluding that the proscribed type of clauses impeded effective regulation.

The Commission found the proscribed indefinite escalation clauses inconsistent with effective regulation for several reasons. Initially, it is important to remember that the Natural Gas Act contemplates that increased rates will be filed only if two factors are present. First, there must be no contractual or other legal inhibition to a filing. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332; *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division*, 358 U.S. 103; *Amerada Petroleum Corp.* v. *F.P.C.*, 293 F. 2d 572 (CA10), certiorari denied, 368 U.S. 976.

Second, the proponent of the increased rate must go on record that the new rate is economically justifiable and that the rate is filed on that basis. For Section 4 (a) and (b) of the Act imposes a positive duty upon natural gas companies to charge rates that are just, reasonable and not unduly discriminatory or preferential and makes it the responsibility of the Commission to provide the sanctions that will enforce that duty. See *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246. To implement the latter consideration, the Commission's regulations require pipeline companies to furnish extensive cost information to support their increased rate filings. Section 154.63 of the Commission's regulations, 18 CFR 154.63, as amended, 27 Fed. Reg. 9500 (September 26, 1962). Such pipeline filings usually relate to all of the company's rates and services. Major independent producers, whose increased rate filings generally relate only to a single rate schedule, are required to submit a "full statement in support of the proposed change in rate" if it is higher than the applicable area price. Section 154.94(f) of the Commission's regulations, 18 CFR 154.94(f), as amended, 27 Fed Reg. 252 (Jan. 10, 1962). In addition, the Commission expects the proponent of an increased rate to stand ready to make an immediate showing that his new rate is just and reasonable since Section 4(e) of the Act imposes that burden of proof upon him. Thus, in *H. L. Hunt, et al.*, 28 FPC—, 46 PUR 3d 62, the Commission dismissed, after hearing and prior to the end of the five-month suspension period, a number of increased rate filings where the producers had failed to make out a *prima facie* case in support of those findings. See also *e.g., F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145; *Episcopal Theological Seminary* v. *F.P.C.*, 269 F. 2d 228 (C.A.D.C.), certiorari denied *sub nom. Pan American Petroleum Corp.* v. *F.P.C.*, 361 U.S. 895; *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 236 F. 2d 606 (C.A.3).

Partly in recognition of these considerations, the Commission issued its regulations limiting the types of price-changing provisions that would be permissible in producer contracts. For the indefinite price escalation provisions which the Commission declared to be against public policy were found to have induced rate increases to be filed which were nowise, even ostensibly, predicated on the economic needs of the producer at the time of the filing.[11] This is so because favored-nation and unlimited price-redetermination clauses, similar to those included in petitioner's contract here, contractually authorize a price increase by the seller under a particular contract solely on the ground that sellers under other contracts in the same general area have contracted to sell or are selling at higher prices. The Commission's experience demonstrated that when such contracts have been made or such higher prices have been collected, producers with such favored-nation or price-redetermination provisions have filed to increase their prices as quick-

[11] Superior, in its brief (pp. 20, 43–44, 47–48), distorting the Commission's statement, not only erroneously claims that the Commission said the price-changing provisions themselves (rather than the filings thereunder) are not ostensibly based upon economic justification, but ignores that essential difference in attacking the reasonableness of the Commission's conclusions. In permitting multiple fixed escalation or limited price redetermination provisions the Commission recognized the desirability of some additional flexibility "to cope with possible changing economic conditions over the span of long-term contracts" (see Order No. 232A, 25 FPC 609), but not at the expense of impeding effective regulation.

ly as possible solely for that reason.[12] As the Commission explained in its *Pure Oil Co.* decision, rendered after an extensive hearing relating specifically to the validity of a favored-nation provision (25 FPC at 389):

> * * * There need be no economic or other substantial justification for the increase; the mere fact that a higher price is paid to some other producer would be sufficient to activate the increase. In our view, such an artificial ground for a proposed increase, operating in such a mechanical and arbitrary manner, and lacking any substantial relationship to the factors which bear on the value of gas or on a determination of a reasonable level of rates for it, does not constitute a proper basis for filing proposed increased rates or a sufficient justification for our giving effect to such a filing * * *.

And, of course, as we have discussed, *supra*, pp. 15–16, the restriction on the types of permissible price-changing provisions in producer contracts does not "cut off other avenues by which a producer may make provision for filing of increased rates" (Pet. Br. App. B, p. 15a, 27 FPC at 340).

---

[12] The impact on consumers from the favored-nation clause increases related to the *Pure Oil* case, were described by the Commission as follows (25 FPC at 389):

"* * * Thus, evidence adduced by El Paso indicates that escalation increases under clauses like those of Pure if activated by West Texas' sales will total some 18 million dollars annually. Furthermore, El Paso states that the filing of such increases for its gas supply will require the company to file for proposed increases in its rates. And it points out that by reason of spiral escalation clauses in its contracts with Phillips Petroleum Company, Phillips is entitled to and probably will file for an increase based upon El Paso's increase to its customers. Since Phillips will be permitted to collect this increase under refund obligation, says El Paso, once again the other producers will be entitled to file for increased rates under their escalation provisions and the cycle will start anew. According to El Paso, if the Pure rate increases here sought become effective, El Paso's gas purchase costs directly and indirectly will be increased in amounts ranging from $35 million to $51 million annually, in excess of El Paso's rate increases sought in its rate filing in Docket No. G–17929." [Footnote omitted.]

2. *The proscribed clauses raise needless complexities frustrating rate regulation*

a. Difficulties in determining contract authority to file.—Not only has the Commission's experience shown that the escalation provisions of the type proscribed have resulted in a flood of almost simultaneous filings without any indication that such filings were even ostensibly predicated upon the financial needs of the filing company, but the difficulties of determining whether there is contractual authority for such filings under such clauses has created an administrative problem of major proportions. The complexity of such contract provisions requires the Commission to spend an undue time interpreting contract price escalation provisions at the expense of determining whether the rates are just and reasonable. This conflicts with the mandate in Section 4(e) that the Commission shall give preference to the hearing and decision of questions relating to the reasonableness of increased rates "over other questions pending before it and decide the same as speedily as possible." The contract interpretation problem stems from the fact, as held in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.* 350 U.S. 332, that under Section 4(d) and (e) of the Act the Commission must reject increased rate filings if they are contractually prohibited. Accordingly, the *Mobile* case imposes a burden upon the Commission to determine in the first instance whether an increased rate filing is contractually authorized.

Of course, if an increase is based on a contract provision permitting an increase to a specific amount on a particular date, no difficult contract interpretation problem arises and hence such provisions were not proscribed, no matter how great their frequency or how great the permissible rise. But when filings are based on increased rates under other sales, complicated factual and interpretative problems frequently must be resolved at the threshold to determine if a tendered rate filing is in fact contractually permitted. *Pure Oil Co.*, 25 FPC 383, affirmed, 299 F. 2d 370 (CA7), is illustrative of this point. One of the favored-nation clauses there involved provides (25 FPC at 386):

> * * * In determining whether the price payable under such other contract or agreement is "higher" than the price payable for gas under this agreement, due consideration shall be given to the provisions of this agreement as compared with such other contract or agreement as to quantity and quality of gas, delivery pressures, gathering and compressing arrangements, provisions regarding measurement of gas, taxes payable on or with respect to such gas, and all other pertinent factors.

That clause, which is typical of many proscribed escalator provisions, shows that before it can be ascertained if a higher price is being paid under another contract so as to justify an increased rate filing, the Commission must make numerous comparisons to fulfill its *Mobile* obligation.[13] In *Pure,* the Commission observed (25 FPC at 390):

> * * * According to staff, a comparison of all the factors listed in the contracts involved herein would necessitate many dozen different comparisons. At the least, as this case demonstrates, the interpretation and application of such clauses involve controverted factual problems and difficult legal questions. * * *

And while questions of contract construction are not within the area of Commission expertise to which the courts should defer,[14] when a rate is filed the Commission, under *Mobile,* must initially construe that contract, regardless of the weight

---

[13] The triggering under the proscribed favored-nations and price redetermination clauses in Superior's contract depends upon similar comparisons. Thus under the favored-nations clause the triggering occurs if the buyer pays another seller a higher price "for comparable gas delivered under comparable conditions" (R. 32). The redetermination clause similarly requires "consideration" of "all pertinent factors."

[14] In *Pure Oil* v. *F.P.C.*, 299 F. 2d 370, 373, 374 (CA 7), while the court held that the scope of certain contract language, namely, the scope of the comparability language quoted above and particularly the meaning of "all other pertinent factors", was not a matter of Commission expertise, the evaluation of the comparative factors—there whether the gas involved in the triggering sale possessed exceptional qualities for peaking purposes so that the price was not comparable—was regarded by the Court as matters "subject to the application of the Commission's expert knowledge and judgment in a technical field," which the court could not review *de novo.*

its construction receives on judicial review. The history of the *Shell* litigation, which twice reached the Supreme Court, gives ample demonstration that the question of whether a favored-nation clause was triggered may involve very difficult and complex questions of contract law, capable of being resolved only after extended litigation. See *Texas Gas Transmission Corp.* v. *Shell Oil Co.*, 363 U.S. 263; on remand to the Third Circuit, *Shell Oil Co.* v. *F.P.C.*, 292 F. 2d 149 (CA 3), certiorari denied, 368 U.S. 915.[15]

In this connection it should be emphasized that, contrary to petitioner's assertions in attempting to rely (Br. pp. 9–10, 51) on certain language in *Mississippi River Fuel Corp.* v. *F.P.C.*, 202 F. 2d 899, 902–03,[16] the administrative difficulties which the regulations are intended to cope with do not arise from shortages in funds or personnel and would not be avoided by additional funds or personnel. Rather the problem is raised by the needless complexity of the price-changing provisions proscribed. For while the Act contemplated that rates would be initiated by private contracts, there is nothing in the Act or its history to even suggest that provisions in con-

[15] The Commission's contract construction was ultimately affirmed in this litigation, after the Supreme Court reversed the court of appeals as to what type of price would trigger a particular favored-nations clause. The second court of appeals opinion resolved a contract construction question not reached by that court originally.

[16] It should be noted that in the *Mississippi River Fuel* case, *supra*, the Court set aside the Commission order only because it overruled the Commission's conclusion that its regulations had not been complied with, so that the procedure there followed in dismissing an increased rate filing was invalid because the Commission relied on a distorted interpretation of the "otherwise clear words of a regulation it has itself adopted." 202 F. 2d at 902. It did not hold that the Commission may not exercise its rule-making authority under Section 16 to make regulation more manageable. Indeed, the Court stated it had no doubt that the Commission could by regulation require rate "schedules and supporting data to be organized or broken down in convenient and readily comprehensible form" (202 F. 2d at 902), *i.e.*, regulations to enable more effective administration of the Act. The court expressly assumed (202 F. 2d at 901) that the Commission could "reject" a proposed filing which did not conform to such Commission rules or regulations. In *Atlantic Seaboard Corp.* v. *F.P.C.*, 201 F. 2d 568, 570–571 (CA4), the court similarly approved the Commission's authority to make such regulations and to reject filings which are not in conformity with such regulations.

677819—63——3

tracts which are vestigial remainders of an unregulated era of gas production must be permitted to frustrate regulation.

And such frustration results if contracts are so involved and complex that extensive hearing or argument is required to ascertain in the first instance whether a filing is contractually authorized.[17] A natural gas company, before putting a new rate into effect is required to give thirty-days' notice to the Commission and the public pursuant to Section 4(d) of the Act. The Commission may suspend such a rate for five-months, but thereafter the rate may be put into effect subject to refund. As the Tenth Circuit has said, the "obvious purpose for granting suspension powers to the Commission was to provide a status quo of five months during which the Commission could investigate the *reasonableness* of the proposed new rate schedule." [Emphasis supplied.] *Phillips Petroleum Co.* v. *F.P.C.*, 227 F. 2d 470, 474 (CA10), certiorari denied *sub nom. Michigan Wisconsin Pipe Line Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005. But in a case such as *Pure Oil Co., supra,* the Commission is faced with a threshold question of contract interpretation and application which delays and even prevents consideration of the reasonableness question during that time.[18]

---

[17] It may be noted that the price-redetermination provision in petitioner's contract might require the Commission to determine a "reasonable market price," assuming that is different from a just and reasonable rate, before it could fulfil its duty to determine the just and reasonable rate. Under that clause (R. 31) if the seller requests a redetermination, the parties shall "attempt to determine the then reasonable market price of the gas." No provision is made for determining the price in the absence of agreement. Assuming such a clause is enforceable (see *Beech Aircraft Corp.* v. *Ross*, 155 F. 2d 615 (CA10); but see Restatement of Contracts, Section 32), a filing by the seller absent such agreement might require a threshold determination by the Commission of whether the rate filed represented the "reasonable market price" within the meaning of the contract. In addition, the Commission might also have to decide whether, absent agreement by the parties, a new rate could be filed at all prior to a judicial determination of the "reasonable market price."

[18] While such rates would presumably be collected subject to refund after a five months suspension, it has been recognized that that remedy by no means affords consumers the full protection from excessive charges which is the primary purpose intended to be achieved by the Natural Gas Act. As the Supreme Court has recently stated in *F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145,

"* * * True, the exaction would have been subject to refund but experience has shown this to be somewhat illusory * * *. It is, therefore, the duty of *b. Uncertainty as to level of claimed triggering price.*—Another impediment to effective regulation arising from the proscribed provisions grows out of the fact that the precise amount of the contractually permitted price increases may be unascertainable until the level of the triggering price or prices is finally determined in a Commission rate proceeding on the triggering sale price. See, *e.g., Phillips Petroleum Co.* v. *F.P.C.*, 227 F. 2d 470 (CA10), certiorari denied *sub nom. Michigan Wisconsin Pipeline Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005. Indeed, under the favored-nation clause in Superior's contract (R. 32), El Paso is to pay Superior as much as it is paying to others for comparable gas. But if a higher amount to another seller is being paid subject to a Commission imposed obligation to refund in certain contingencies, it would seem apparent that the amount to which Superior would be contractually entitled for sales on any given date could not be ascertained until the contingency of the triggering rate is removed. Similarly, under a redetermination clause, such as that in Superior's contract here, the contract rate may not have been determined at the time of filing.[19] In such circumstances, the Commission, at the time such an indeterminate rate is filed, does not have the opportunity efficiently to exercise its discretion as to whether the proposed increased rate should be suspended and set for hearing since it cannot then know the actual level of the proposed increased rate.

3. *The proscribed clauses prevent proper consideration of all relevant factors in certificate regulation*

a. Producer certificates.—In addition to frustrating effective rate regulation the proscribed clauses also constitute an impediment to effective certificate regulation. As this Court is aware, in issuing certificates to producers the Commission has

the Commission to look at the 'backdrop of the practical consequences [resulting] * * * and the purposes of the Act,' *Sunray Mid-Continent Oil Co.* v. *Federal Power Comm'n.*, 364 U.S. 137, 147 (1960), in exercising its discretion under § 16 to issue interim orders * * *."

[19] For example, in *Pan American Petroleum Corp.*, FPC Docket No. RI63-3, the producer has filed for an increased rate based on a redetermination clause calling for a "fair and reasonable" price, the amount of which was still in litigation at the time of filing. See suspension order in that proceeding of July 12, 1962, 27 Fed. Reg. 6856 (July 19, 1962).

an obligation to determine the impact of proposed producer prices and to "hold the line." *E.g., Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378; *United Gas Improvement Co.* v. *F.P.C.,* 283 F. 2d 817 (CA9), certiorari denied *sub nom. Superior Oil Co.* v. *United Gas Improvement Co.,* 365 U.S. 879, and *California Co.* v. *United Gas Improvement Co.,* 365 U.S. 881. Such an obligation obviously carries with it a responsibility to compare the terms of contracts, not just the initial price. *United Gas Improvement Co.* v. *F.P.C., supra,* 283 F. 2d at 823 (CA9).

To illustrate this, let us assume that in a given area the Commission had been unconditionally certificating sales where the contracts called for an initial price of 18¢ with no provisions for any type of price escalation for five years. At the same time, it has rejected certificates where the initial sales price was 19¢ on the ground that it was out of line, that collection of the 19¢ rate, even subject to refund, would trigger price increases, and that there was no need for gas at such a high price. It would seem apparent that a sales contract calling for an 18¢ price for the first thirty days of delivery, with an escalation to 19¢ thereafter would be equally as objectionable as the initial 19¢ price. An 18¢ initial price which could be escalated under a favored-nations clause at any time would also appear to be equally objectional, because the 19¢ price might be reached just as quickly. This example shows why the Commission has regarded it as necessary to fulfill its function of giving "a most careful scrutiny and responsible reaction to initial price proposals of producers under § 7" (*Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378, 391) to look at more than just the price for the first day of delivery to determine if the price provisions of new contracts are comparable to those previously approved.[20] However, as long as

---

[20] See *Trunkline Gas Co.,* 21 FPC 704, petition for review dismissed, *sub nom. Public Service Commission of New York* v. *F.P.C.,* 284 F. 2d 200 (CADC). There the Commission, in certificating a higher initial price than any previously approved, explained (21 FPC 719): "* * * these contracts provide for a firm 20 cent price for a period of ten years, without escalations or redeterminations. We look with favor on such firm contracts which serve to relieve the pressure on the rising spiral of producer prices caused by the usual provisions for escalations and redeterminations found in most contracts. We emphasize, however, that in the absence of this provision for

new producer contracts contained completely indefinite price escalation provisions a meaningful comparison with other contracts could not be made except in rare instances. Standardization of the triggering mechanisms allowed in producer contracts will contribute to permitting more realistic comparisons in the Commission's effort to comply with this and other courts' repeated commands to "hold the line".

b. Pipeline certificates.—Moreover, the existence in producer contracts of the proscribed escalation provisions has also, as was found in Order 232 (App. A, *infra,* p. 50), "contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies." This is so because one of the prerequisites to issuance of a certificate of public convenience and necessity to a pipeline company for new facilities is a showing that a sufficient market exists to justify the new construction. See, *e.g., Kansas Pipe Line & Gas Co.,* 2 FPC 29, 45–46. Such a showing, of course, includes evidence as to the market of the distribution companies. While this type of showing necessarily will depend upon estimates of sales and revenues, such estimates even for the three to five year period after commencement of service will be very speculative, at best, if the gas supply for the project is based

---

a firm price, we would not be persuaded that the 20 cent price is required by the public convenience and necessity; and, it will not be sufficient for producers hereafter seeking certificates to support their applications by reference to our action in this proceeding without taking proper account of this factor of firm price. We shall closely scrutinize any such proposed sales in this area under contracts which provide for price escalations or redeterminations above 20 cents per Mcf within a period of five years, and in the absence of a clear showing that such prices are required by the public convenience and necessity, we shall either deny the applications or impose price conditions."

And in establishing its area price for increased rates with respect to four Texas districts the Commission has varied the level depending on the terms of the contracts involved. Section 2.56 of the Commission's regulations, 18 CFR 2.56. Thus, while increases to 14 cents will be suspended if there is no limitation on the price changing provisions, increases to 14.6 cents will not be suspended if favored-nation and price-redetermination provisions have been eliminated, while 15 cent rates will not be suspended if periodic escalations have been eliminated as well. In making this distinction, the Commission has relied upon its action in accepting numerous settlements as to rates for sales from those areas, including contract renegotiations making such modifications.

upon contracts containing provisions such as the proscribed favored-nation and unlimited price redetermination clauses. For in such circumstances no *maximum* gas supply cost can be realistically estimated by the distributing company and hence the "estimates" as to number of prospective natural gas consumers, which depend in part at least on the relative costs of natural gas, fuel oil or coal, cannot be realistically evaluated. As a result of the increases in the cost of natural gas that had occurred for ten or fifteen years, until recently checked, the competition with other fuels has become more acute. See, *e.g.*, *Northern Natural Gas Co.*, 22 FPC 164, 523, affirmed *sub nom. Minneapolis Gas Co.* v. *F.P.C.*, 278 F. 2d 870 (CADC), certiorari denied, 364 U.S. 891; see also, *Hearings on the Natural Gas Act (Exemption of Producers) before the House Committee on Interstate and Foreign Commerce,* 84th Cong., 1st Sess., pp. 631, 811–818, 824–828. These circumstances provided further substantial basis for the regulations by providing not only a sounder basis for the Commission to evaluate prospective market demand in pipeline certificate proceedings, but also by permitting more realistic planning for pipeline development and expansion.

The foregoing considerations show that the Commission had a reasonable basis for promulgating the challenged rule. To affirm the Commission, the Court does not, however, have to agree with all of the Commission's conclusions or decide that it would have acted precisely as the Commission did. For it is the function of the Commission, not the courts, to legislate interstitially and the courts will set aside such actions only if no reasonable predicate therefor is apparent, even if the court might disagree with the wisdom of the regulation. See, *e.g., American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298, 314; *American Telephone & Telegraph Co.* v. *United States,* 299 U.S. 232, 236–237.

II. The Commission has authority to regulate contract provisions by rule

An important part of Commission regulation of public utilities is through the issuance of general rules and regulations fixing detailed rights and duties to carry out or administer the terms of the regulatory statute without the necessity for case-by-case decision of the same issue with respect to every individual utility. The Federal Power Commission's authority to issue rules and regulations is specifically set forth in Section 16 of the Natural Gas Act, which provides in pertinent part:

> The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. * * *

As the Tenth Circuit has recently had occasion to conclude, this is "a sweeping grant of administrative authority to be exercised in the sound discretion of the Commission." *Amerada Petroleum Corp.* v. *F.P.C.*, 293 F. 2d 572, 575, certiorari denied, 368 U.S. 976. And while we agree with petitioner (Br. p. 34, 36) that this broad authority may not be used in a manner inconsistent with the Act, the Commission's rules in this case are not only not inconsistent with the Act but are, indeed, predicated on the substantive powers found in specific sections of the Act. In issuing the challenged rules, the Commission was thus legislating interstitially, as contemplated by the Act. See, *e.g.*, *S.E.C.* v. *Chenery Corp.*, 332 U.S. 194, 202; *American Trucking Associations, Inc.* v. *United States*, 344 U.S. 298, 308–313.[21]

A. Sections 4 and 5 of the Natural Gas Act authorize regulation of contracts of natural gas companies

Petitioner is simply wrong in contending that the Natural Gas Act precludes the Commission from modifying contracts.

---

[21] Petitioner's contention (Br., p. 37) that the Commission's rule-making authority is limited to procedural rules is not supported by *Willmut Gas & Oil Co.* v. *F.P.C.*, 294 F. 2d 245 (CADC), certiorari denied, 368 U.S. 975, upon which it seems to rely in this respect. There the court concluded only that Section 16 would not permit the Commission to promulgate rules inconsistent with the statute and thus result in a legislative change. It should be noted that this discussion in *Willmut* related not to an actual Commission regulation but rather to hypothetical regulations which petitioner there argued that the Commission should have adopted to prevent pipelines from filing general tariff increases while a previously filed increase was still pending before the Commission.

This view as to lack of such substantive power is impossible to reconcile with the Commission's express authority to change *"contracts,"* as well as rates. In this section we consider the substantive question of the existence of the authority; in a subsequent section we discuss the question whether such authority may be exercised only on a case-by-case basis or also by rule or regulation (*infra*, pp. 36–41).

Section 5(a) of the Act provides that in passing on existing rates or contracts affecting rates

> Whenever the Commission, after a hearing * * *, shall find that any * * * *contract* affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable * * * *contract* to be thereafter observed and in force, and shall fix *the same* by order * * * [emphasis supplied].

Section 4(e) gives the Commission the same powers over contracts when a company files a changed rate or contract. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332.[22]

The power to modify contracts has been judicially recognized. Thus, in *Mississippi River Fuel Corp.* v. *F.P.C.*, 252 F. 2d 619 (CADC), certiorari denied, 355 U.S. 904, the court sustained a Commission order requiring United Gas Pipe Line Company to disregard a contractual obligation to provide Mississippi with all its natural gas requirements and to insert a take-or-pay clause in the contract. In *Michigan Consolidated Gas Co.* v. *Panhandle Eastern Pipe Line Co.*, 226 F. 2d 60 (CA 6), certiorari denied, 350 U.S. 987, the court recognized the Commission's authority to free Panhandle of a contractual duty to supply Michigan Consolidated a specified amount of gas. See also, *e.g.*, *El Paso Natural Gas Co.*, 13 FPC 421, 456–457 (service agreement provisions dedicating gas from specified reserves to

---

[22] Section 4(e) states that in such a proceeding "the Commission may make such orders with reference [to a changed rate] as would be proper in a proceeding initiated after it had become effective." After a rate has become effective, a proceeding to determine the lawfulness of rates or contracts would be initiated pursuant to section 5(a).

sales to certain customers ordered eliminated). And, of course, when the Commission reduces a natural gas company's contractually established rate it alters the rate provided by the contract.

Petitioner's claims that under the *Mobile* case, *supra,* contract terms are immune from Commission modification are clearly frivolous. For while the Supreme Court there stated that the Natural Gas Act, unlike the Interstate Commerce Act, was not intended "to abrogate private rate contracts as such" (350 U.S. at 338), it also expressly recognized that "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest" (350 U.S. 344). Indeed, in the *Mobile* case the issue was only whether a natural gas company had the right to file an increased rate pursuant to Section 4(d) of the Act when its contract prohibited that filing. Since the Supreme Court held that the Act was not intended to prohibit private rate contracts, it concluded that a seller of natural gas could not invoke the provisions of the Act for the filing of increased rates so long as a contractual inhibition was present. The Court in *Mobile* was concerned with the powers of the seller of natural gas, not with the power of the Commission as such. As we have seen, the Commission's paramount power was recognized and there is nothing in *Mobile* that in any way limits the express powers over contracts conferred by Sections 4 and 5 of the Act.[23]

---

[23] Indefinite price-changing provisions, though in existence to a limited extent in 1938, when the Act was adopted, did not become common earlier than the mid-1940's. See *e.g., Hearings on Natural Gas Act (Exemption of Producers) before House Committee on Interstate and Foreign Commerce,* 84th Cong., 1st Sess., p. 538; 96 Cong. Rec. 4022–4028; Neuner, "The Natural Gas Industry," p. 80–111 (1960). Thus, while allowing rates generally to be initiated by contract, Congress can hardly be charged with approving or even considering all types of contract provisions that might be developed. Moreover, by specifically granting the Commission power to find contracts unlawful pursuant to Section 5(a) of the Act, Congress recognized that the Commission, not Congress, should deal with the evils arising from specific contracting practices as the Commission should find necessary or appropriate. See *American Trucking Associations, Inc.* v. *United States,* 344 U. S. 298, 309-310.

B. Sections 7 (c) and (e) authorize Commission action with respect to rate structures and contracts in issuing certificates of public convenience and necessity

The Commission's power to modify contracts is at least as great in Section 7 proceedings on applications for certificates of public convenience and necessity, as in Section 4 or 5 rate proceedings. Here again we consider the substantive question of existence of the authority, reserving for consideration hereinafter, *infra*, pp. 36–41, how that authority may be exercised.

Section 7 (c) and (e) vest in the Commission the power and duty to control the terms and conditions under which natural gas companies may initiate proposed sales at wholesale prices or transport natural gas in interstate commerce. If a natural gas company does not find such terms and conditions acceptable to it, it is not compelled to initiate the proposed service. This is because there is no dedication to interstate commerce of its properties until gas commences to flow in interstate commerce. *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378, 387.

But the fact that a natural gas company may refuse to render service except on the terms stated in its certificate application does not require the Commission to approve service on those terms unless the public convenience and necessity will be advanced. As the Tenth Circuit has stated (*Sunray Mid-Continent Oil Co.* v. *F.P.C.,* 267 F. 2d 471 at 472, affirmed, 364 U.S. 137), a contrary conclusion would mean that a natural gas company could dictate the terms and conditions of every certificate. This, of course, would be inconsistent with the Commission's power to control initiation of service in order to make regulation more effective.

While the standard of public convenience and necessity is not capable of precise definition, the Commission must give the greatest possible effect to all provisions of the Act, and their policies, in applying this standard. See, *e.g. F.P.C.* v. *Transcontinental Gas Pipe Line Corp.,* 365 U.S. 1; *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378; *United States* v. *Detroit Navigation Co.,* 326 U.S. 236, 241; *cf., National Broadcasting Co.* v. *United States,* 319 U.S. 190, 215–220. Particularly in view of the fact that the primary aim of the Act is "to protect consumers against exploitation at the hands of natural gas companies" (*e.g., Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137, 147; *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610), the Commission must consider rate questions, including the terms of related contracts, in certificate proceedings. See, *e.g., Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378; *United Gas Improvement Co.* v. *F.P.C.*, 283 F. 2d 817, 823 (CA9). While in the *Atlantic Refining Co.* (*CATCO*) case it was held that the Commission was not required to convert every certificate proceeding into a hearing to determine the justness and reasonableness of the initial rates proposed, that case, contrary to petitioner's suggestion, does not preclude as thorough a consideration of either rate or contract matters in certificate proceedings as in a Section 4 or 5 rate case, if the Commission considers this feasible and desirable.

It is, in fact, apparent that when dealing with a rate structure or terms of service for a proposed sale, whether stated in a tariff or contract filed as a rate schedule, modification required by the public interest can be made prior to the commencement of service not only as readily but also, in many instances, with a less disruptive effect upon all parties. For at that time persons objecting to such modifications can still refuse to make or participate in the proposed service if the conditions required by the public interest were unacceptable to them.

The desirability of Commission examination of rate structures, and hence the contracts of which they are made up, before service starts was specifically recognized in Congress when Section 7 of the Natural Gas Act was amended in 1942 to require certificates of public convenience and necessity prior to initiation of any new jurisdictional service.[24] At the same time Congress also added Section 7(e), which prescribes the standards to be applied by the Commission in deciding if a proposed act or service should be authorized. The purpose of these amendments was explained by the House Committee on

[24] Prior to that time, certificates were required only if a company sought to enter a market already being served by another natural gas company.

Interstate and Foreign Commerce in these terms (H.R. Rep. No. 1290, 77th Cong., 1st Sess., pp. 2–3):

> * * * The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves, the feasibility and adequacy of the proposed services, and the characteristics of the rate structure in connection with the proposed construction or extension *at a time when such vital matters can readily be modified as the public interest may demand.* * * * [Emphasis supplied.]

The Senate Committee on Interstate Commerce made a similar explanation [S. Rep. No. 948, 77th Cong., 2d Sess., pp. 1–2]:

> Provisions of the Natural Gas Act empower the Commission to prevent uneconomic extensions and waste, but it can so regulate such powers only when the extension is to 'a market in which natural gas is already being served by another natural-gas company.' Thus the possibilities of waste, uneconomic and uncontrolled extensions are multiple and tremendous. The present bill would correct this glaring inadequacy of the act. It would also authorize the Commission to examine costs, finances, necessity, feasibility, and adequacy of proposed services. *The characteristics of their rate structure could be studied.* * * * [Emphasis supplied.]

See also Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 5249, 77th Cong., 1st Sess., pp. 5–6.

Aside from imposing conditions with respect to the initial prices proposed to be charged by natural gas companies, the Commission has also repeatedly found it necessary to require modification of other tariff or contract provisions as a condition to granting certificates of public convenience and necessity. *E.g.*, *Florida Economic Advisory Council* v. *F.P.C.*, 251 F. 2d 643, 646, 648 (CADC),[25] affirming *Houston Texas Gas and Oil Corp.*, 16 FPC 118 and 17 FPC 303 (condition requir-

[25] Certiorari denied, 356 U.S. 959.

ing elimination of cancellation provisions in transportation agreement); *Northern Natural Gas Co.*, 22 FPC 164, 174–175, 180, affirmed *sub nom. Minneapolis Gas Co.* v. *F.P.C.*, 278 F. 2d 870 (CADC), certiorari denied, 346 U.S. 891 (certificate conditioned upon removal of clauses permitting cancellation depending on price relationship of gas and competitive fuels in gas purchase contracts upon which feasibility of pipeline project depended); *Transwestern Pipeline Co.*, 22 FPC 391, 394–395, modified on rehearing, 22 FPC 542 (minimum bill provisions of proposed tariff required to be modified); *Transcontinental Gas Pipe Line Co.*, 7 FPC 24, 38–40 (commencement of service conditioned upon filing of new tariff satisfactory to Commission because of disapproval of certain terms of service).

The cases upon which petitioner relies (Br. pp. 12–13, 32) fail to support the proposition that the terms of contracts for future sales (which is all that is involved here) are immune from modification by Commission action or cannot be made the basis for rejecting a certificate predicated thereon. To the contrary, the cases relied upon show that existing contracts are subject to Commission revision. Thus, in *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, the Supreme Court held that in issuing certificates the Commission had an obligation to consider the initial price to be charged for the proposed service and, if it issued a certificate, to impose price conditions if the initial price was excessive under Section 7 standards. Since the prices proposed by the producers were fixed by contract, such a price condition necessarily entails modification.

And in both *Texaco Inc.* v. *F.P.C.*, 290 F. 2d 149 (CA 5) (condition imposed after Section 7 hearing), and *H. L. Hunt* v. *F.P.C.*, 306 F. 2d 334 (CA 5), F.P.C. petition for rehearing pending (price condition in temporary authorization), the Fifth Circuit also approved the imposition of initial price conditions upon the issuance of producer certificates, which meant modification of the prices provided by the contracts. While in both of these cases the court held that the modified prices resulting from the Commission imposed "condition" would not provide the same bar under the *Mobile* case to filing of increased rates pursuant to Section 4 of the Act as obligations in a contract of the parties between themselves, in neither case did the court suggest that the Commission could not by proper rule require modification in the form of producer contracts.

In the *Hunt* case, where a rate condition based on the Policy Statement area price was imposed which required a price lower than the contract price for the duration of the temporary certificate, the court also concluded that the Commission could not so condition the temporary authorization. That holding, as to which we petitioned for rehearing *en banc* on August 23, 1962, does not support petitioner, either. The basis of Judge Brown's holding in *Hunt* seems to be that once gas is flowing even under temporary authorization, the statutory right to file increases authorized by the seller's contract may not be taken away by the Commission. But his opinion does not touch the question of the reasonableness of Commission requirements limiting the contract provisions under which it will permit gas to start flowing.

Thus while both of these cases hold that there are limits to the Commission's certificate conditioning power, neither denies the Commission's power by certificate condition to modify the terms of a contract in a Section 7 certificate proceeding. To the extent that *Texaco* and *Hunt* limit the type of condition that the Commission may impose they are irrelevant here where the reasonableness of the Commission's basis for denying certificates based on contracts containing the proscribed indefinite pricing clauses is clear. And *Texaco* expressly states that the Commission could deny out of hand a certificate if the public convenience and necessity did not warrant granting it on the basis of the terms of the proposed contract. 290 F. 2d at 155.

C. The procedural provisions of Sections 4, 5 and 7 do not curtail Commission authority under Section 16 to carry out by general rule the regulation of contracts authorized by those sections

There is no basis for petitioner's contentions (*e.g.,* Br. pp. 8–18, 30–34) that the Commission cannot carry out the regulation of contracts authorized in Sections 4, 5 and 7, by general regulations issued under Section 16, because the provisions of Sections 4, 5 and 7 in terms call for hearings and findings prior to Commission action on a rate or certificate filing. In this regard it should be noted that in issuing the challenged regulations the Commission was basing its actions on considerations applicable generally to independent producers; petitioner does not show or even suggest that the validity of the rate changing provisions, as opposed to particular rates, depends upon circumstances peculiar to itself. Its contention is simply that since the substantive authority to change contracts stems from Sections 4, 5 or 7, the Commission cannot, because of the hearing requirements of Sections 4, 5 and 7, achieve by rule-making that which it could achieve on a case-by-case approach. A virtually identical contention was rejected by the Supreme Court in *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192.

In the *Storer* case, which arose under the Communications Act, the court below had held, as petitioner argues here, that the general rule-making authority of that Commission could not be exercised to limit the right of applicants to a hearing, because the court felt that Section 309(b) of that Act, 47 U.S.C. 309(b), in specifically referring to a hearing prior to denial of any application meant that "any citizen who seeks a license for the lawful use of an available frequency has the undoubted right to a hearing before his application may be rejected." 220 F. 2d at 208. It, therefore, concluded that the rules there in issue,[26] insofar as they required the threshold denial of license applications inconsistent with the rule, were invalid. In reversing the court of appeals and upholding that Commission's authority to act by rulemaking, the Supreme Court said (351 U.S. at 202–203):

> We do not read the hearing requirement, however, as withdrawing from the power of the Commission the rulemaking authority necessary for the orderly conduct of its business. As conceded by Storer, "Section 309(b) does not require the Commission to hold a hearing before denying a licence to operate a station in ways contrary to those that the Congress has determined are in

[26] The rules limited the number of radio and television channels that any person could own or control.

the public interest." The challenged Rules contain limitations against licensing not specifically authorized by statute. But that is not the limit of the Commission's rulemaking authority. 47 U.S.C. § 154(i) and § 303(r) grant general rulemaking power not inconsistent with the Act or law.

This Commission, like other agencies, deals with the public interest. * * * [Footnote omitted.]

In reaching this conclusion, the Court had pointed out (351 U.S. 201–202):

> The Commission asserts that its power to make regulations gives it the authority to limit concentration of stations under a single control. It argues that rules may go beyond the technical aspects of radio, that rules may validly give concreteness to a standard of public interest, and that the right to a hearing does not exist where an applicant admittedly does not meet those standards as there would be no facts to ascertain. The Commission shows that its regulations permit applicants to seek amendments and waivers of or exceptions to its Rules. It adds:
>
> "This does not mean, of course that the mere filing of an application for a waiver * * * would necessarily require the holding of a hearing, for if that were the case a rule would no longer be a rule. It means only that it might be an abuse of discretion to fail to hear a request for a waiver which showed, on its face, the existence of circumstances making application of the rule inappropriate." [Footnotes omitted.]

The same considerations are applicable here. For at the time a certificate or rate filing was made, petitioner was free to seek waiver or modifications of the regulations and obtain a hearing if such a request showed on its face, reasons for such action. See, *supra*, p. 17. Petitioner did not request a waiver, but only contended that a hearing was required on any filing made pursuant to Sections 4 or 7 of the Act. It may be noted that the Commission has recently granted rehearing to consider whether the regulations here involved should be modified to permit escalation clauses in producer contracts which allow producers to change the price under a particular contract at will, subject only to Commission regulations. *Atlantic Refining Co.*, F.P.C. Docket No. CI63–576, order issued February 21, 1963. In granting rehearing, the Commission observed that, while such a provision was clearly prohibited by Section 154.93 of its regulations, "the propriety of such a provision, which is not typically found in contracts between independent producers and pipelines, was not a matter which engaged the Commission's consideration at the time it adopted its present rule." Moreover, the Commission will provide a hearing if a question arises as to whether or not a particular contract contains nonpermissible price changing provisions. Such a hearing is being held in *Atlantic Refining Co.*, F.P.C. Docket No. CI62–1562, pursuant to an order of September 13, 1962, granting rehearing of a rejection order, 27 Fed. Reg. 9362, September 20, 1962.

But otherwise there is no right to a hearing every time a proscribed contract provision is sought to be filed. The Power Commission, as shown above, *supra*, pp. 29–36, has fully established authority to regulate the terms included in contracts of natural gas companies in either rate or certificate proceedings. Here the challenged rule generally proscribes certain types of price-changing provisions which the Commission found to be contrary to the public interest in that their existence tended to frustrate the effective regulation contemplated by the Act. Petitioner, who has had the complete opportunity to submit written data, comments, or views prior to the issuance of the challenged rules (the procedure required for general rulemaking by Section 4(b) of the Administrative Act, 5 U.S.C. 1003 (b)),[27] contends only, as did Storer, that the Commission must proceed by a case-by-case method, even though no facts are in dispute and no circumstances are even suggested to differen-

[27] Petitioner's reference (Br., p. 36) to the Orders 232, 232A, and 242, by which the challenged regulations were promulgated, as "ex parte" orders does not comport with the facts. In this respect, it should be noted that in the *Storer* case, the Supreme Court observed that the rules there involved, which were issued upon the filing of written data, comments, views, and oral argument (18 Fed. Reg. 7796, December 3, 1953), and, as here, without any evidentiary hearing, had been promulgated after "extensive administrative hearings." 351 U.S. at 205.

677819—63——4

tiate petitioner or its needs from other independent producers. As Judge Learned Hand stated (*National Broadcasting Co.* v. *United States,* 47 F. Supp. 940, 945 (SDNY), affirmed, 319 U.S. 190):

> * * * Such a doctrine would go far to destroy the power to make any regulations at all; nor can we see the advantage of preventing a general declaration of standards which, applied in one instance, would in any event become a precedent for the future. * * * [28]

See also *S.E.C.* v. *Chenery Corp.,* 332 U.S. 194; *Logansport Broadcasting Corp.* v. *United States,* 210 F. 2d 24 (CADC); 1 Davis, *Administrative Law, Treatise,* pp. 407–411 (1958)).

Moreover, as the Supreme Court also held in *Storer* in approving the provision of the challenged rules that provided for rejection without hearing of license applications in conflict with the standards announced by the rule (351 U.S. 192 at 205):

> * * * We do not think Congress intended the Commission to waste time on applications that do not state a valid basis for a hearing. If any applicant is aggrieved by a refusal, the way for review is open.

Rejection of unauthorized rate filings without a hearing is also firmly established. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.,* 350 U.S. 332, 347; *Amerada Petroleum Corp.* v. *F.P.C.,* 293 F. 2d 572 (CA10), certiorari denied, 368 U.S. 976.[29] As has recently been stated in a case approving rejection

[28] In this respect, it should be reiterated that, in addition to following the requirements of rule-making procedures, the Commission was able to place reliance on its decision in *Pure Oil Co.,* 25 FPC 383, affirmed 299 F. 2d 370 (CA7), where the validity of a favored-nations clause was at issue. The Commission may, in either adjudicatory or rulemaking proceedings, rely on its accumulated experience in earlier proceedings and is, of course, not precluded from relying on decisions in prior cases as precedent on questions of law, including policy determinations such as those here involved. Any other course, would make either the judicial or administrative processes completely unworkable.

[29] Indeed, in *Sun Oil Co.* v. *F.P.C.,* 266 F. 2d 222 at 226 (CA5), affirmed, 364 U.S. 170, the Fifth Circuit, in a case where the Commission had rejected a certificate application and an initial rate filing, stated that there is "no need for the holding of a formal hearing and the taking of testimony where

by the Interstate Commerce Commission of a motor carrier's tariff where no certificate authority existed, a tariff or rate filing not based on certificate authority is properly rejected. *W. J. Dillner Transfer Co.* v. *United States,* 31 U.S. L. Week, 2414 (U.S.D.C.W. Pa.—three-judge court).

Moreover, in promulgating general rules, as in legislation there is no constitutional right to an evidentiary hearing. See, *e.g., Bi-Metallic Investment Co.* v. *State Board of Equalization,* 239 U.S. 441; *Bowles* v. *Willingham,* 321 U.S. 503, 519–520.

And, contrary to petitioner's unsupported claims (Br. pp. 14, 34), the Fifth Amendment does not necessarily protect persons from legislative action even if that action may result in a drastic economic impact. See *American Trucking Associations, Inc.* v. *United States,* 344 U.S. 298. There the Court held (344 U.S. at 322–323);

> * * * As we have indicated, the rule-making power is rooted in and supplements Congress' regulatory scheme, which in turn derives from the commerce power. The fact that the value of some going concerns may be affected, therefore, does not support a claim under the Fifth Amendment, if the rules and the Act be related, as we have said they are, to evils in commerce which the federal power may reach. This being the case, appellants had no constitutional claim in support of which they are entitled to introduce evidence *de novo,* and the court did not err in sustaining the objection thereto. [Footnote admitted.] [30]

---

no fact issue was presented." *Cf. Denver Stock Yard Co.* v. *Producers Livestock Marketing Association,* 356 U.S. 282, 287, affirming, *Producers Livestock Marketing Association* v. *United States,* 241 F. 2d 192, 196 (CA 10); *Sun Oil Co.* v. *F.P.C.,* 256 F. 2d 233, 240–241 (CA5), certiorari denied, 358 U.S. 872.

[30] While the challenged regulations here involved have only prospective effect, administrative rules which affected existing rights have also been judicially approved. Thus, in *Air Line Pilots Association, International* v. *Quesada,* 276 F. 2d 892 (CA2) and 286 F. 2d 319 (CA2), certiorari denied, 366 U.S. 962, the Administrator of the Federal Aviation Agency prescribed a regulation prohibiting pilots over age 60 from piloting carrier aircraft. Objection was made that this was arbitrary, discriminatory, violated existing collective bargaining agreements and was a denial of due process because individual hearings were not afforded. The Court, in upholding the author-

III. Rejection of petitioner's filings was not discriminatory

A. Petitioner's reliance on the *Memphis* case, which relates to pipeline companies, is misplaced

Petitioner's contentions (Br. pp. 21, 52–54) that the regulations are discriminatory because pipelines are not subjected to the same regulations are completely baseless. It is obvious that a mere difference in treatment of pipelines and producers does not invalidate a regulation. Section 16 of the Act specifically provides that "[f]or the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

Since soon after the Supreme Court's *Phillips* decision in 1954 (*Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672), the Commission's regulations have, in large measure, accorded different treatment to pipeline companies and independent producers. Thus the filing requirements in both certificate and rate proceedings are much less detailed for independent producers than for pipelines. Compare Sections 154.1 through 154.86 of the Commission's Regulations under the Natural Gas Act, 18 CFR 154.1–154.86, with Sections 154.91 through 154.103, 18 CFR 154.91–103 (relating to rates); also compare Sections 157.5 through 157.22, 18 CFR 157.5–157.22, with 157.23 through 157.31, 18 CFR 157.23–157.31 (relating to certificates). Similarly, while a uniform system of accounts has been prescribed for pipeline companies of all sizes, none has been adopted for producers, and there are different requirements with respect to annual reports. Clearly then petitioner's claim based on a mere difference is without any significance.

As we have shown, *supra,* pp. 18–28, the challenged regulations are reasonable as applied to independent producers and are required to permit effective regulation of the producer segment of the natural gas industry. And while price-changing provisions, which in effect permit the pipelines to make *ex parte*

---

ity to issue such regulation, stated (276 F. 2d at 896): "* * * All private property and privileges are held subject to limitations that may reasonably be imposed upon them in the public interest. Only when the limitations are too stringent in relation to the public interest to be served are they invalid. * * *"

rate filings, are standard in pipeline service agreements (see, *e.g., United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division,* 358 U.S. 103), this is no indication of an arbitrary difference in treatment since no similar need for regulation has been experienced with respect to pipelines. This stems in large part from the fact that pipelines, unlike producers, do not seek rate increases for sales to individual distributing companies, but file instead company-wide increases to reflect overall increased costs in the operations. Moreover, in the case of pipelines, such company-wide increases are required by the applicable regulations to be supported at the time of filing by substantial cost data amounting to a full factual justification of the new rate. See Section 154.63 of the Commission's regulations, 18 CFR 154.63, as amended, 27 Fed. Reg. 9500 (September 26, 1962). Producers, by contrast, not only have continued to establish rates by individual contract but, in addition, their increased rate filings normally relate to such contracts or at most, to only a small portion of their total operation.

Furthermore, reliance (Pet. Br. pp. 25–26) on the language in *Memphis* (358 U.S. at p. 113) that "[b]usiness reality demands that natural gas companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance" is misplaced. For that language does not mean that any type of escalation provision however invidious must be tolerated. To the contrary, while the Court in *Memphis* stated that this objective of producing adequate revenues was taken into account by the Congress in part by "preserving the 'integrity' of private contractual arrangements for the supply of natural gas, 350 U.S. at 344," the Court also stated that such arrangements were *"subject of course to any overriding authority of the Commission."* [Emphasis added.] Here this overriding authority has, as discussed, *supra*, pp. 18–28, been exercised to prevent gas supply arrangements which by their very existence are an impediment to the effective regulation the Act was intended to achieve, a factor not found to exist by either the Commission or the Court in *Memphis.* Indeed, any other result in that case would have meant that under the existing service agreements the pipeline would have been precluded from making any increased rate filings without approval of its customers, no specific escalation being authorized in any of the long-term service agreements.

B. The Commission was not required to accept petitioner's filings because it had accepted comparable filings based on contracts pre-dating Order 242

Petitioner's further contention (Br. pp. 19–22, 42–43) that the rejection of its certificate application and related rate filing was discriminatory because the Commission had at earlier dates granted certificates for sales on identical terms from the same field is patently without merit. As has been shown, the rejection of petitioner's filings here resulted from that fact that they were based on a contract executed subsequent to the effective date of Order 242; the similar filings to which petitioner refers all pre-date the present regulations promulgated by Orders 232A and 242. Petitioner, both before and after the adoption of the regulations limiting the types of price-changing provisions in producer contracts, was and is being treated the same as anyone else.[31] Neither it nor anyone else has a vested right to be granted a certificate based on certain types of contract provisions which the Commission had previously accepted. No prior Commission decision can bar its continuing reexamination of the facts or policy considerations as they affect the public interest. See *F.C.C.* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 156. The cases relied upon by petitioner in no way support its view that an intervening rule of general applicability does not fully explain and justify the differences in treatment of which it complains. In *Episcopal Theological Seminary* v. *F.P.C.*, 269 F. 2d 228, 237 (CADC), certiorari denied *sub nom. Pan American Petroleum Corp.* v. *F.P.C.*, 361 U.S. 895 (Pet.

[31] The certificate application and rate schedule filing of Humble Oil & Refining Company relating to Humble's fifty-percent interest in the same acreage here involved, to which Superior referred (R. 117) in its certificate application, was rejected for the same reasons as Superior's. Humble, however, thereafter amended its contract by making the favored-nations and price redetermination provisions of the contract adopted reference inapplicable to the post-Order 242 supplemental agreement. As amended, Humble's filings have been accepted.

Br. pp. 19, 43), the court merely indicated that unexplainable differences in treatment of similarly situated producers would not be permissible. However, it affirmed the Commission suspension of one company's increased rate, although another company's increased rate for a sale to the same buyer under the same contract had previously not been suspended, since it appeared that the earlier action had been inadvertent. In *Sohio Petroleum Co.* v. *F.P.C.*, 298 F. 2d 465 (CA10) (Pet. Br. p. 43), the court disapproved the Commission's requirement that a particular type of fuel adjustment clause be eliminated from a producer's contract as a condition for the grant of temporary authorization to sell gas, where such provision had previously been included in numerous contracts in the area. The Commission action there was, however, based not on a rule of general applicability promulgated after extensive administrative proceedings, as here, but only on a statement of policy issued without any prior Commission proceedings.[32]

It should also be pointed out that in making this contention petitioner baldly states that the rejected filings were not based on a new contract. But clearly the April 9, 1962, agreement here involved is a new contract. Admittedly, the parties, instead of writing an entirely new document, found it more convenient to incorporate by reference terms of an existing contract between the same parties for gas from adjacent acreage. But since nothing in the incorporated contract required or even contemplated that sales from any additional acreage would have to be made subject to the same terms, petitioner's claim that the so-called supplemental agreement of April 9, 1962, was not, as a matter of law, a new contract is frivolous. And, of course, the labelling of the certificate application as an amendment does not alter the fact that the authority to sell from the new acreage required new certificate authorization pursuant to Section 7(c) and (e) of the Act. *Cf. Montana Power Co.* v. *F.P.C.*, 298 F. 2d 335, 339 (CADC).

[32] Though the *Sohio* case is thus clearly different from the present case, it should be pointed out that the Commission does not believe that the *Sohio* case was properly decided.

IV. The legality of contract clauses in the absence of Commission action does not preclude their prospective elimination

Contrary to petitioner's suggestion (Br. pp. 23–28), cases in which the courts have given effect to rates increased under indefinite escalation clauses in contracts approved by the Commission in certificate cases do not impugn the Commission's power to proscribe such clauses prospectively. For the legality *vel non* of a contract provision as a matter of general law, is not necessarily controlling on the question of its legality under a supervening regulatory scheme—a matter to be administratively determined. See *Southwestern Sugar & Molasses Co.* v. *River Terminals Corp.*, 360 U.S. 411, 416–418; *Pennsylvania Water & Power Co.* v. *F.P.C.*, 343 U.S. 414, 421–423.

Moreover, even if the Commission had previously expressed approval of the provisions now proscribed, the only question for a court in passing on the regulation proscribing them would be to determine if there is presently a reasonable basis for doing so. In *American Trucking Associations, Inc.* v. *United States*, 344 U.S. at 298, where the approved regulations in effect outlawed trip-leasing practices previously approved, the Court observed in this respect (344 U.S. at 314):

> * * * The mere fact that a contrary position was taken during the war years when active interchange and leasing were required, that the Commission has never before restricted trip-leasing and has in fact approved it from time to time, does not change our function. [Footnote omitted.]

But the fact is that the Commission has long regarded indefinite escalation provisions with disfavor. Indeed, from December 17, 1954 (13 F.P.C. 1576, 1584) until amended by Order 242, Section 157.25 of the Commission's regulations under the Natural Gas Act, which relates to producer certificate applications, provided (18 C.F.R. 157.25):

> * * * Escalation clauses in contracts submitted hereunder on or after May 1, 1955, will not be considered in support of any certificate application or otherwise given effect by the Commission if under such clauses: (a)

> provision is made for adjustment of the price of the seller by reason of changes in the prices received by the purchaser upon resale; or (b) if provision is made for adjustment of the price of the seller by reason of the payment of higher prices by other purchasers in the same or other producing areas.

And the proceeding resulting in Order 232 was commenced in April, 1956. As petitioner points out (Br., pp. 26–27), the Commission in its annual reports to Congress from 1956 through 1960, included in its overall recommendations for modifying independent producer regulation a request that such clauses be outlawed in existing as well as future contracts. Thus, the Commission has consistently expressed its view that these clauses are against public policy.[33]

---

[33] Petitioner seems to view the Commission's legislative recommendations as support for its position that the Commission may not proceed by regulation. These recommendations were not only part of a package, as we have stated, but by relating to clauses in existing contracts went beyond the Commission's present regulations. Moreover, since the Commission disapproved indefinite escalation provisions, though its rule-making procedures had not been completed, requests for Congressional action similar to existing bills then pending certainly provides no indication that the Commission doubted its authority to proceed on its own. For Congressional proscription of indefinite escalation provisions as part of a package might have avoided the drawn out litigation challenging these regulations.

CONCLUSION

For the reasons stated, the Commission's order should be affirmed.

Respectfully submitted.

RICHARD A. SOLOMON,
General Counsel,

HOWARD E. WAHRENBROCK,
Solicitor,

PETER H. SCHIFF,
Attorney,
For respondent.
Federal Power Commission,
Washington 25, D.C.

MARCH 11, 1963.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

______________________________,
Attorney.

APPENDIX A

United States of America
Federal Power Commission

Before Commissioners: JEROME K. KUYKENDALL, *Chairman;* FREDERICK STUECK, ARTHUR KLINE and PAUL A. SWEENEY

Docket No. R–153

NONACCEPTABILITY OF CONTRACTS BETWEEN PRODUCERS AND INTERSTATE NATURAL-GAS COMPANIES CONTAINING CERTAIN TYPES OF AUTOMATIC ESCALATION AND FAVORED NATION CLAUSES

(18 CFR 154.91(a) and 154.93)

ORDER NO. 232

Amending the Commission's General Rules and Regulations

(Issued March 3, 1961)

In this proceeding, the Commission has under consideration a proposed amendment of § 154.93 of its General Rules and Regulations (18 CFR 154.93) respecting the filing of rate schedules containing certain provisions for adjustments in the price of the seller, e.g., "favored-nation", "redetermination", and "spiral escalation" clauses.

General public notice of this proposed rule-making was given by publication in the Federal Register on April 12, 1956 (21 FR 2388) and mailing notices to interested parties, including State and Federal regulatory agencies.[1]

[1] This issue was also fully tried, briefed, and argued before the Commission in *The Pure Oil Company*, Docket No. G–17930, in which decision is being issued this day.

In response to such notice, numerous suggestions and comments were submitted by interested parties respecting the changes in the Commission's rules therein proposed. All such suggestions and comments have been carefully considered, but, for reasons set forth in our findings, we adhere to the rule as originally proposed with certain changes made thereto.

The Commission finds:

(1) The natural gas industry and natural gas service are aided and developed by the use of long-term contracts for the sale of natural gas by producers to pipeline companies or to others, and it is desirable and appropriate in the public interest that long-term contracts be utilized as a basis for considerations of supply and service expansions by natural gas companies.

(2) Long-term gas supply contracts containing provisions for rate changes dependent or based in part on "indefinite escalation clauses", as herein defined, have contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies. As found by us in the proceeding of *The Pure Oil Company,* Docket No. G–17930, Opinion No. 341 issued concurrently herewith, these indefinite escalation provisions are contrary to the public interest. Such escalation provisions, therefore, are undesirable, unnecessary, and incompatible with the public interest for the due and proper development of natural gas service by natural gas companies.

(3) It is necessary and appropriate in the public interest and in the proper administration of the Natural Gas Act that § 154.91(a) of our General Rules and Regulations (18 CFR 154.91(a)) be amended to include definitions of "definite escalation clause" and "indefinite escalation clause" to define clearly the amendment necessitated by our findings in subparagraph (2) hereof.

The Commission, acting pursuant to authority granted by the Natural Gas Act, particularly Sections 4, 7, and 16 thereof (15 U.S.C. 717c, 717f, and 717o), *orders:*

(A) Part 154, entitled Rate Schedules and Tariffs and Subchapter E—Regulations Under Natural Gas Act, Chapter I of Title 18, Code of Federal Regulations, is amended as follows:

(1) In § 154.91(a), change the caption "Definition" to read *"Definitions (1)"* and adding subparagraphs (2) and (3) to read:

"(2) 'Definite escalation clause' means any provision in an independent producer's contract for the sale of natural gas in interstate commerce for resale or the transportation of natural gas in interstate commerce which sets forth the price to be paid for natural gas delivered thereunder in terms of a specific price per unit, including, in addition to the initial price, any increases therein by specific amounts at definite future dates, or any provision which changes the specific price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller.

"(3) 'Indefinite escalation clause' means any provision, other than a definite escalation clause as defined in subparagraph (2) hereof, under which the price in a contract for the sale or transportation of natural gas by an independent producer subject to the jurisdiction of the Commission may be determined or changed."

(2) Adding a proviso at the end of § 154.93, *Rate schedule defined,* to read as follows:

"Provided, That any provision for a change of price of the seller by reason of indefinite escalation clauses, as defined in § 154.91(a)(3), contained in a contract for the sale or transportation of natural gas subject to the jurisdiction of the Commission tendered for filing on and after April 3, 1961, shall be inoperative and of no effect at law."

(B) These amendments shall become effective April 3, 1961. Any interested person may submit to the Commission on or before March 20, 1961, views or comments in writing concerning these amendments.

(C) The Secretary of the Commission shall cause publication of this order to be made in the Federal Register.

By the Commission. Commissioner Kline, concurring in part and dissenting in part, filed a separate statement.

[SEAL] JOSEPH H. GUTRIDE, *Secretary.*

KLINE, Commissioner, *concurring* in part and *dissenting* part

I concur completely in the rule insofar as it renders void and inoperative favored nation, spiral escalation and price redetermination clauses in future contracts. I feel such clauses are definitely contrary to the public interest when appearing is gas contracts subject to our regulation.

I am opposed to the rule insofar as it renders void and inoperative provisions in producer contracts permitting price changes arrived at through negotiation or arbitration after a period of five years from the date of the contract. The broad definition of the term "indefinite escalation clause" contained in the rule would eliminate these as well as other unspecified contractual provisions.

It is the practice in the industry for producers to enter into long term contracts for the sale of gas. Such contracts usually run for twenty years or the life of the field which may be fifty or more years. The Commission encourages such long term contracts and this order itself contains a finding that they are in the public interest. It is impossible for anyone to predict with accuracy the economic conditions so far in the future, what the costs of a producer will be at that time, or what will constitute a just and reasonable price for gas. Yet under the law a natural gas company is bound by its contract and may not unilaterally file for increased rates. *United Gas Pipe Line Co.* vs. *Memphis,* 358 U.S. 103; *United Gas Pipe Line Co.* vs. *Mobile,* 350 U.S. 322. Under such circumstances a producer should have a contractual right to renegotiate his contract price at some time in the future in order to protect himself against inflation or other unforeseen contingencies. He should not be compelled to agree at the beginning of his contract to a fixed price for the gas twenty or fifty years in the future, when conditions may be wholly different.

Many producers have already substituted such negotiation and arbitration clauses in their contracts in lieu of the favored nation and spiral escalation clauses. We have never had a hearing on the issue of whether such provisions are contrary to the public interest, the majority has failed to give any reason for outlawing them, and I can see no reason why we should not permit them.

A contract providing for re-negotiation of the price at some future date, and for arbitration in event the parties fail to agree, merely gives the producer the right to file for such price. The Commission will, of course, disallow it in event it is not a just and reasonable price. Since the gas is already committed to the pipeline, the producer will not have any distinct bargaining advantage. If anything, he will be at a disadvantage, and I see no reason to fear that excessive prices will result, even during the temporary suspension period, as a result of a negotiation and arbitration clause.

I appreciate the difficulty we have in stabilizing gas prices and I would have no objection to a rule finding that it is in the public interest to eliminate even the right to negotiate for a period during which we can reasonably expect economic conditions not to undergo too radical a change, such as a five year period.

In the *Memphis* case, *supra,* the Supreme Court sustained the contention of this Commission that a natural gas company should have the contractual right to file for an increase even though the amount of the increase is not specifically stated in the contract. We cannot arbitrarily abolish that right but can do so only if the contractual provision supplying the right is against the public interest.

Finally, the adoption of such a broad rule seems to me to be extremely short sighted. Once a rule such as this is adopted, the average businessman, as a matter of self preservation, will seek to avoid its effects. Here the producer will undoubtedly seek to protect himself by increasing the initial price or providing for steeper escalations or through some other means. We impliedly put our blessing on definite escalation clauses regardless of the amount. I consider a contract provision calling for a five cent escalation every five years far worse than a contract provision calling for a one cent escalation with the additional provision for negotiations. Yet the adoption of such a rule as this cannot help but lead to some such results.

In summary, I am opposed to the rule as written because we have never published notice of any intention to adopt such a rule, no showing has been made that all outlawed clauses are against the public interest, and I believe a producer should not be required at his peril to attempt to set prices twenty years in the future, but should be afforded some reasonable means of negotiating a price at a time when he knows the conditions with which he will be faced.

ARTHUR KLINE, *Commissioner.*

APPENDIX B

United States of America
Federal Power Commission

(Received, May 4, 1956)

Docket R–153

Non-Acceptability of Contracts Between Producers and Interstate Natural Gas Companies Containing Certain Types of Automatic Escalation and Favored Nation Clauses

---

Protest of The Superior Oil Company

Now comes The Superior Oil Company, called hereinafter "Superior", a corporation organized under the laws of the State of California, with a principal place of business at 400 Oil & Gas Building, Houston 2, Texas, in response to notice concerning the above matter involving a proposal to amend Part 154 entitled "Rate Schedules and Tariffs of Sub-Chapter E, Regulations Under the Natural Gas Act, Chapter 1 of Title 18, Code of Federal Regulations." Superior is an independent producer within the definition thereof in Section 154.91 of Commission Order No. 174–B, although the validity of such order and the legality of its application to Superior is expressly denied. Subject to said denial Superior submits this protest to said proposed rule.

I

Basically Superior opposes this rule on the following several grounds:

(1) The proposed rule would violate the Fifth Amendment of the Constitution of the United States protecting the liberty and freedom of contract.

677819—63——5

(2) The proposed rule is beyond the authority of the Federal Power Commission as delegated by the Natural Gas Act.

(3) The proposed rule would cause irreparable damage to independent producers required to comply therewith during the period of time following its adoption and the time it could be judicially considered and condemned.

(4) No rule should now be adopted which will affect the sale of natural gas by independent producers for a long period of time regardless of changes in the Natural Gas Act, or its interpretation, in view of the congressional dissatisfaction with said Act as evidenced by the "Kerr Bill" [1] and the "Harris Bill",[2] which have failed of becoming law only by reason of presidential vetoes, and particularly since the last veto message recognized the need for amendment of said Act.

II

The right of independent producers and their vendees to provide for future prices on any basis that said parties mutually deem proper is protected by the Fifth Amendment to the Constitution.[3] While such freedom is not absolute, "* * * freedom of contract is, nevertheless, the general rule and restraint the exception * * * justified only by the existence of exceptional circumstances." [4] The purchaser requires stability of supply of natural gas and recognizes the market price of such gas will be influenced by the law of supply and demand, the forces of inflation, and other economic factors which will fluctuate during any period of years. The producer not only wants the fair market price for his product at the inception of the sale, but so long as the sale continues, and is often legally obligated to

---

[1] The Kerr Bill, S. 1498, 81st Congress, 1st Session.

[2] The Harris Bill, H.R. 6645, 84th Congress, and Veto Message February 17, 1956.

[3] *Adkins* v. *Childrens Hospital*, 261 U.S. 525, 43 Sup. Ct. 394; 67 L. Ed. 785. "That the right to contract about one's affairs is a part of the liberty of the individual protected by this (due process clause of the Fifth Amendment) clause is settled by the decision of this Court and is longer open to question.

[4] *Adkins* case, *supra*.

his royalty owners to pay such price at all times. The Commission has heretofore adopted Order 174–B which effectively prevents the *operation* and *consideration* of contract clauses of the general type it now proposes to proscribe. Without arguing at this time the propriety of Order 174–B (which prohibits the automatic operation of such clauses and eliminates their consideration), it is obvious that the Commission has found a method to fully protect what it deems to be the public interest without condemning a whole contract or attempting to write a contract for the parties. To provide that no contract may include such a clause, which is the effect of the proposed order, is an arbitrary and unreasonable infringement of the liberty of contract not required for protection of the public interest.

III

The proposed rule is completely beyond the authority of the Federal Power Commission. The recent decision by the Supreme Court in the "United" case [5] interpreting the Natural Gas Act clearly so holds. It was there said: "The basic power of the Commission is neither one of 'rate making' nor 'rate changing' but merely to set aside and modify any rates or contracts found after hearing to be unjust * * * ", etc. If, as was said in that case, the Natural Gas Act permits the relationship between the parties to be established initially by contract, subject to review by the Commission in connection with the protection of the public interest, it is clearly apparent that the Commission cannot *determine what contracts or what provisions of contracts may or may not be entered into by the parties subject to its jurisdiction.* The sole authority of the Commission is to *review* such contracts and if provisions thereof be found to be not in the public interest, suspend, modify or deny the operation of such provisions. The unfettered right to contract is a necessity under the rule announced in the "Sierra" case.[6] There the Supreme Court held that while the Commission could not

[5] *United Gas Pipe Line Company* v. *Mobile Gas Service Corporation,* decided February 27, 1956, opinion by Justice Harlan reversing Court of Appeals' decision, 215 Fed. 2d, 883, official reporter citation not yet available.

[6] *Federal Power Com.* v. *Sierra Pacific Power Co.*, decided February 27, 1956. Opinion by Justice Harlan on certiorari from decision reported 223 Fed. 2nd 605 (official reporter's citation is not yet available).

fix rates which were unreasonably low it could permit rates to stand which were unreasonably low if the parties had agreed to such rates unless overall financial ability of the company would be so impaired as to hinder continued public service.

IV

The proposed rule will cause irreparable injury to independent producers in many instances, even though said rule is finally declared invalid. Under existing Rule 174–B an independent producer must file with the Commission a rate schedule covering each interstate sale of natural gas. A rate schedule is defined as "the basic contract and all supplements or agreements amendatory thereof." [7] If the proposed rule is adopted the independent producer is faced with a dilemma. He is required to file his sales contract to avoid violation of the Act with resulting penalties provided therein, but the contract may not include provisions which business experience has shown are necessary for his economic protection, are acceptable to his purchaser, and which to date the courts have found to be legal and proper. He is bound by his contract as filed notwithstanding that the Commission rule which prevented him from including such protective provisions in the contract may have been held invalid long before the contract terminates. Nor may the independent producer obtain protection through the process of making only a short term contract for there is grave doubt as to whether a jurisdictional sale once commenced may be discontinued regardless of the expiration of the contract period.[8] Should the proposed rule be adopted, the independent producer is helpless to protect himself in the event the rule is determined to be invalid or is voluntarily repealed by the Commission.

---

[7] Sec. 154.93, General Rules & Regulations of Federal Power Commission.

[8] Examiner's decision G–3038, et al., October 6, 1955, in *The Matters of J. M. Huber Corporation, et al.*, "Even though Huber, under the provisions of the contract could have terminated it, Huber would not have been relieved from the necessity of meeting the statutory requirements of Sec. 7(b) * * *", etc. *Fed. Power Com.* v. *J. M. Huber Corp.*, 133 F. Supp. 479. In the Matters of *Dixie Pipe Line Co., et al.*, G–2041, et al., Commission Opinion No. 285, Sept. 9, 1955.

V

The proposed rule to exclude whole contracts if they include particular clauses is wholly unrealistic, unfair and unreasonable. The scope of regulation of independent producers by the Federal Power Commission is presently undetermined. In view of congressional efforts to amend the Natural Gas Act,[9] it is reasonable to assume that the jurisdiction of the Commission over rates and charges of independent producers will be changed by changes in the basic Act. This is particularly true since the last congressional effort to amend the Act failed by reason of presidential veto, yet the veto message proclaimed the amendment of the Act to be meritorious and in the national interest.[10] To adopt rules at this time requiring or prohibiting provisions of long term contracts is arbitrary and an abuse of power. Certainly all contracts are subject to valid provisions of the Natural Gas Act since no one can validly contract contrary to law. Order No. 174–B which provides that "no consideration" shall be given to certain clauses is based on such rule and is a proper *type* of regulation to announce the policy decisions of the Commission concerning such clauses. To go further and specify what the contract shall provide is going beyond the realm of law enforcement. Even the courts cannot do this.

Wherefore, it is urged that the proposed amendment to Rule 154.93 as set forth in Docket R–153 be found against the public interest, contrary to law, and therefore be rejected.

Respectfully,

THE SUPERIOR OIL COMPANY,
By: H. W. VARNER,
Its Attorney,
Houston, Texas, April 30, 1956.

Of Counsel:
W. B. WAGNER,
H. W. VARNER,
400 Oil & Gas Bldg.,
Houston 2, Texas.

[9] The Kerr & Harris Bills, supra.

[10] "At the same time, I must make quite clear that legislation conforming to the basic objectives of H.R. 6645 is needed." Veto message February 17, 1956. U.S. Code Congressional and Administrative News, 84th Congress, 2nd Session, 1956, No. 3, Page 729.

APPENDIX C

United States of America
Federal Power Commission

(Received, November 13, 1961)

Docket No. R–203

In the Matter of Rejecting of Sales Contracts Containing Indefinite Escalation Clauses and of All Applications Relying Upon Such Contracts for Gas Supply

---

Views and Comments of The Superior Oil Company

Comes now The Superior Oil Company ("Superior") and pursuant to Notice of Proposed Rule Making issued in Docket No. R–203 on October 10, 1961, submits its views and comments with respect to the proposed amendments to the Federal Power Commission's ("Commission") Regulations under the Natural Gas Act ("Regulations"). As Superior is classified by the Federal Power Commission as an "independent producer", Superior limits its comments to the proposed amendment to Sections 154.93 and 157.25 of the Regulations. However, these comments are equally applicable to the remaining sections referred to in the Notice.

Superior believes the proposed amendments to the Regulations are unlawful and exceed the powers granted to the Commission under the Natural Gas Act; contrary to the public interest; unnecessary and prematurely proposed; and arbitrary, unreasonably and discriminatory.

The proposed rule changes will drastically curtail the initial rate-making rights of independent producers in a manner never intented by Congress under the Natural Gas Act.

The Commission is given no jurisdiction or power to review contracts, as such, except the power provided by Section 5(a) of the Act, i.e., "to set aside and modify any rate or contract which it determines, after hearing, to be 'unjust, unreasonable, unduly discriminatory or preferential' ".[1] This is not a power to make rates or dictate contract terms, it "is simply the power to review rates and contracts made in the first instance by natural gas companies".[2] Moreover, by the express language of the statute the power may only be exercised after hearing.

"The limitation imposed on natural gas companies" with regard to contracts "are set out in Sections 4(c) and 4(d)" of the Act. The basic duties are the filing requirements: "Section 4(c) requires schedules showing all rates and contracts in force to be filed with the Commission and Section 4(d) requires all changes in such schedules likewise to be filed".[3] "In short, the [Natural Gas] Act provides no 'procedure' either for making or changing rates" or rate contracts.[4] The "rate-making [and contract-making] powers of natural gas companies [under the Act] were to be no different from those they would possess in the absence of the Act: to establish ex parte, and change at will, the rates offered to prospective customers; or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer. * * * [The] initial rate-making and rate-changing powers of natural gas companies remain undefined and unaffected by the Act".[5]

In its *Mobile* decision the Supreme Court emphasized as set forth above that natural gas companies have the power "to establish *ex parte*, and change at will, the rates offered to prospective customers." [6] The proposed rule, if it be construed to deny the right to make the Memphis [7] type filings, requires natural gas companies to contract away the right "to change" at will (subject to the Commission's powers of review) the rates at which it will provide natural gas. While the Supreme Court recognizes that a natural gas company may agree by contract not to make *ex parte* changes in rates, the Court's language

[1] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), at 341.

[2] See Fn. 1, *supra*, at 341.

[3] See Fn. 1, *supra*, at 341 and 342.

[4] See Fn. 1, *supra*, at 343.

[5] See Fn. 1, *supra*, at 343.

[6] See Fn. 1, *supra*, at 341.

[7] *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103 (1958).

clearly shows the Natural Gas Act did not affect the fundamental right of natural gas companies to file *ex parte* changes in their rates, nor did it accord the Commission the arbitrary right to void such right as the Commission rule would do if not set aside. In its *Memphis* [8] decision the Supreme Court pointed out that "united, like the seller of an unregulated commodity, has the right in the first instance to change its rates as it will, unless it has undertaken by contract not to do so".[9]

The rule change proposed in Docket No. R–203 overlaps what may be found to be the unlawful action taken by the Commission in Order No. 232A, issued March 31, 1961. Validity of Order No. 232A is presently in litigation,[10] and may well be litigated in other forums before the extent of the Commission's interdictive power over the [sic]

If, either in the Sun Oil Company litigation or in the case of an actual implementation of Order No. 232A, the Commission's attempt to outlaw indefinite pricing arrangements will be held invalid, the proposed rule change would be equally unlawful. In the meantime, application of the proposed rule change will irreparably damage countless producers who will be precluded from filing contracts containing indefinite pricing provisions. In the premises the only possible purpose and effect of the proposed rule change is temporarily to close any avenue of escape which might be available to gas producers in the event Order No. 232A is invalidated. Surely, this is an injustice.

The proposed rule change is clearly discriminitary in that it imposes upon natural gas companies which are independent producers entirely different standards than those under which natural gas companies which are pipelines or distributors must operate. In prescribing the types of pricing provisions which

---

[8] *Ibid.*

[9] See Fn. 7, *supra.*

[10] See Fn. 7, *supra.*

Order No. 232A outlaws indefinite price escalation provisions by rendering "inoperative and of no effect at law" any price increase provision in contracts executed after April 3, 1961, at variance with the types specified in the order. The types permitted are: provisions for reimbursement of changes taxed upon the seller: provisions for definite increases upon definite dates; and provisions for price redetermination based upon Commission approved prices at five-year intervals during which there is no definite increase. (*Sun Oil Company* v. *F.P.C.* No. 19, 001 5th Cir.)

will be allowed independent producers, the Commission proscribes all other pricing arrangements, including that arrangement which is most commonly used by other classes of natural gas companies, the tariff. Under the tariff system, a pipeline company can file for a rate increase of any magnitude at any time, subject only to the limitations of Section 4(e) of the Act. It is clearly discriminatory to allow such provisions in the contracts of one class of natural gas company, while forbidding it in the contracts of another. For such reason, the proposed rule change is arbitrary, unreasonable, and violates the rights of independent producers by confiscating a valuable property right without due process of law. The Commission has indicated that it does not believe that the prohibition placed upon indefinite pricing provisions in any manner limits the rights of independent producers to freely contract the sale of natural gas. The Commission's position as stated in the staff's brief in the *Sun Oil* case [11] is that an independent producer who seeks to utilize a pricing clause prohibited by the Order might either apply to the Commission under Section 1.7(b) of the Regulations for a repeal of the rule or, in the alternative, enter into a short-term contract which would ultimately convert to a tariff arrangement at the end of the primary term. It is obvious that these are not alternatives at all and provide a completely unrealistic approach to the problems faced by the independent producers. In the first instance, if the Commission fails to act upon the motion for repeal of the rule, the proponent of such change is completely without a remedy. With regard to the latter proposal, contracting for the purchase and sale of natural gas is a two-way street. Long term contracts, price considerations aside, are equally for the protection of buyer and seller and insure the seller that the gas produced during the declining period of production, where the seller has limited flexibility, will find a market.

Under the indefinite pricing clauses proscribed by the Commission's Regulations, the pipeline purchaser has it within his power to control the triggering of indefinite pricing provisons. Under the proposal made by the staff for a short-term con-

---

[11] See Fn. 10, *supra*.

tract followed by a tariff, the pipeline companies would have no control over producer filings whatsover.

In the absence of the right to make contracts with indefinite pricing provisions, the producers are left at their peril to attempt to set prices for many years in the future, a task no producer would undertake willingly. In summation, the proposed rule changes must not prohibit the natural gas companies from "increasing the prices of their product whenever it is economically necessary [as a] means of keeping the intake and outgo of their revenue in proper balance, * * *."[12]

The changes proposed by the Commission, as well as those adopted by the Commission's Order of March 31, 1961, Order No. 232A, are contrary to the public interest and patently unnecessary. The Commission, if it intends to seek the elimination of indefinite pricing provisions, could have accomplished its purpose by a statement of general policy similar to 61–1. This would have advised the independent producers that if they proposed such provisions in any contracts they must show the particular set of circumstances requiring such a provision. This would allow the producers to justify their proposed indefinite pricing provisions on a proper record and would allow the producers a route to appeal to the courts for relief if they believed the Commission's decision erroneous. If the Commission believed such provisions so vitiated the contract as to make it not in the public interest, the Commission clearly has the power under the Natural Gas Act to deny a Certificate of Public Convenience and Necessity to the independent producer.

WHEREFORE, The Superior Oil Company opposes adoption of the rule change as proposed and requests that the Commission defer action with respect to the proposal until such time as the validity of Order 232A is determined.

THE SUPERIOR OIL COMPANY,
By: HOMER J. PENN, *Attorney.*

NOVEMBER 10, 1961.

[12] See Fn. 7, at 103.

APPENDIX D

United States of America
Before the Federal Power Commission

(Received March 8, 1962)

Docket No. R–203

REJECTION OF SALES CONTRACTS CONTAINING INDEFINITE ESCALATION CLAUSES AND OF ALL APPLICATIONS RELYING UPON SUCH CONTRACTS FOR GAS SUPPLY

Petition for Rehearing of The Superior Oil Company

Comes now The Superior Oil Company (Superior), under the provisions of Section 19(a) of the Natural Gas Act (15 U.S.C. Sec. 717r(a)), called herein "the Act, and files this application and petition for rehearing of Order Number 242 which was issued in the captioned docket on February 8, 1962, and would show to the Commission as follows:

1. Superior has a number of gas sales contracts with favored nation clauses and other "price changing provisions" other than those defined as permissible in the subject order. Superior contemplates that in the future it will execute and file with the Commission other gas sales contracts containing such provisions, which provisions are in general use in the industry and have been found by experience necessary for industry welfare over a period of many years.

2. In issuing the captioned order the Commission exceeded its statutory power in prescribing the terms of contracts under which a producer may sell its gas. Except as restricted by the express or implied provisions of the Act, a natural gas company possesses the same freedom in respect to the making of contracts which it would have in the absence of the Act. The Act does not grant to or take from natural gas companies their power to provide for rates initially by contract or otherwise, subject to

modification by the Commission after hearing and upon a finding that they are unjust and unreasonable or unlawful. The comprehensive statutory scheme set up by the Act is that the natural gas company *makes* contracts and the Commission reviews such contracts *after* they are made. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.* (1960), 358 U.S. 103; *Amerada Petroleum Corp.* v. *F.P.C.* (10 Cir. 1961), 293 F. 2d 572; and *Willmut Gas & Oil Co.* v. *F.P.C.* (D.C. Cir. 1961), 294 F. 2d 245. To paraphrase Judge Miller in *Willmut:* The initial rate-making and rate-changing powers of the natural gas companies remain unaffected by the Act. An order or regulation requiring rejection of applications for certificates because the underlying gas sales contract contains a favored nation clause or any type of indeterminate pricing provision would deny to Superior the right to makes its initial contracts, which right the *Mobile* decision pointedly affirms to be in a natural gas company.

Judge Harlan said in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.* (1956), 350 U.S. 332, 341:

> These sections are simply parts of a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. The Act merely defines the review powers of the Commission and imposes such duties on natural gas companies as are necessary to effectuate those powers; it purports neither to grant nor to define the initial rate-setting powers of natural gas companies.
>
> The powers of the Commission are defined by Secs. 4(e) and 5(a). The basic power of the Commission is that given it by Sec. 5(e) to set aside and modify any rate or contract which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential". This is neither a "rate-making" nor a "rate-changing" procedure. It is simply the power to review rates and contracts made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them * * *.

This Commission Order directly conflicts with the above decision and amounts to a legislative change which is beyond the authority of the Commission.

3. The Commission's Order denies to Superior the right to prove the justness and reasonableness of agreed upon future prices by refusing in advance to accept any contract in which the parties have so agreed with the minor and arbitrary exception commented upon hereinbelow. Under established law Superior as a gas producer subject to the Act cannot even seek an increase in price, regardless of its justness and reasonableness, until it has the contractual consent of the purchaser to pay such price, subject, of course, to Commission's final determination of the lawfulness of such price. The Commission has denied to Superior the right to obtain this contractual consent. The Order recognizes that: "The Natural Gas Act contemplates that prices, to be just and reasonable, be related to economic needs." Yet the Commission by this order denies to Superior the right confirmed to it by the Act itself to seek rate increases when it feels that it can prove the justness and reasonableness of such rates. Since a prerequisite in a producer's increased rate filing is the contractual consent of the buyer, which this order would prevent Superior from obtaining, such order denies to Superior the right to seek rate increases which are or may be fully justified by economic need.

4. The Order denies due process of law to Superior and its purchasers of gas by denying them the right to contractually provide for and consent to prices which they feel should be applicable during the 20-year term of a gas sales contract. The Order recognizes that "the Natural Gas Act contemplates that rate increases shall be sought when there is economic justification * * *", yet it solemnly pre-judges future economic requirements without any basis of fact, or any hearing in which facts relevant thereto might be adduced.

5. The Order is incompatible with the statutory scheme of effective rate regulation which contemplates change, and impliedly precludes the fixing of a permanent price ceiling. The effect of a present determination that any increase in producers' prices in excess of 1¢ per MCF each five (5) years, or a total price increase of 3¢ per MCF during the next twenty (20) years,

without any hearing, or a factual basis is arbitrary on its face. Even the most talented and qualified economic prophet cannot with responsibility now so predict. Certainly such a determination is unreasonable and unlawful when made without a hearing and behind the closed doors of the Commission Chambers.

The Commission Order refers to cases under the Interstate Commerce Act. The difference between the powers of the Interstate Commerce Commission and those of the Federal Power Commission in the fixing of rates has been pointed out in *Mobile, supra,* Page 345. See also *Willmut, supra.* Mere administrative convenience through the elimination of the right to present matters which present problems for determination is no substitute for justice or due process of law.

Premises considered, Superior respectfully urges that a rehearing be granted and that upon reconsideration the Commission rescind its Order No. 242.

Respectfully, submitted,

THE SUPERIOR OIL COMPANY.
(S) H. W. Varner,
H. W. VARNER,
Attorney.

Of Counsel:
H. W. VARNER,
The Superior Oil Company,
P.O. Box 1521, Houston 1, Texas.
HOMER J. PENN,
The Superior Oil Company,
909 RCA Building, 1725 K Street, N.W.,
Washington 6, D.C.

U.S. GOVERNMENT PRINTING OFFICE: 1953